

**An Audit of
Milwaukee Public Museum, Inc.
2005 Financial Crisis
Final Report**

December 2005

Committee on Finance and Audit

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December 1, 2005

To the Honorable Chairman
of the Board of Supervisors
of the County of Milwaukee

We have completed an audit of the Milwaukee Public Museum, Inc. 2005 Financial Crisis. This final audit report builds upon an interim report, issued in June, that presented an overview of financial management activity and general conclusions regarding factors leading to MPM's 2005 financial crisis. This final report addresses, in greater detail, the trends and financial practices in recent years that lead to MPM's financial position.

A response from MPM is included as **Exhibit 7**. We appreciate the cooperation extended by the MPM Board and its staff during the audit.

Please refer this report to the Committee on Finance and Audit.

Jerome J. Heer
Director of Audits

JJH/cah

Attachment

cc: Milwaukee County Board of Supervisors
Scott Walker, Milwaukee County Executive
Linda Seemeyer, Director, Department of Administrative Services (DAS)
Stephen Agostini, Acting Fiscal and Budget Administrator, DAS
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Summary

Milwaukee County officials were notified by the Milwaukee Public Museum, Inc. (MPM) on May 3, 2005 that a newspaper story would be published the next day highlighting a significant negative financial result for fiscal year (FY) 2004 operations. The disclosure of a \$4.1 million reduction in net assets (recently revised to a final audited figure of \$6.4 million) triggered a series of events including:

- Resignations of the MPM Chief Executive Officer, the Chairman of the MPM Board of Directors and the Chairman of the MPM Audit and Finance Committee (the Chief Financial Officer of MPM had resigned on April 15, 2005);
- A decision by Milwaukee County to not execute a new 20-year lease and management agreement;
- Downsizing of MPM staff by approximately 42%, from 269 positions in January 2005 to 157 positions in November 2005;
- Appointment of a five-member Financial Oversight Committee to monitor all MPM financial transactions as a condition of receiving Milwaukee County backing for \$6 million of credit; and
- Initiation of a Milwaukee County audit.

Our interim report in June 2005 presented an overview of MPM governance and financial management that led to the financial crisis facing the museum. This final report presents, in greater detail, factors that led to MPM's near insolvency in May 2005.

2005 Financial Condition

As of August 31, 2005, MPM's preliminary financial statements indicate a continuation of the deteriorating financial trend noted in our interim report, with an anticipated, non-audited net asset loss of \$10.4 million for FY2005. Those same financial statements show MPM had borrowed \$4.5 million from its Endowment Fund, including approximately \$1 million in permanently restricted funds.

Current Financial Condition

With the assistance of a Milwaukee County-backed credit totaling \$6 million and the addition of the County-appointed Financial Oversight Committee, MPM has established a break-even operating budget for FY2006 totaling \$12.7 million, representing a 42% reduction from its approved FY2005

expenditure budget of \$22.0 million. This break-even budget does not address MPM's substantial long term debt.

Financial Trends

Section 2 of this final audit report recaps MPM's overall financial trends identified in our interim report, and updates those trends with additional data obtained for FY2004 and FY2005. The trends show that a distinct trend of declining contributions and operational losses, at the same time that MPM was pursuing a strategy of growth, brought the institution to a crossroads at fiscal year-end 2002. The disparate trends continued at an accelerating pace through FY2004 and FY2005, culminating in the financial crisis publicly acknowledged in May 2005.

Financial Reporting and Oversight

In our previous report, we noted that while MPM Board meeting minutes contained clues about the deterioration of MPM's financial condition, it did not appear that the severity of the situation was ever disclosed directly by management or probed into by Directors until early in 2005.

Since our June 2005 report, we have reviewed MPM financial transactions, management reports provided to the MPM Board of Directors, and various related correspondence during the period spanning MPM's fiscal years 2002 through 2005, in greater detail. Based on our review, we believe the former CFO engaged in a series of actions that concealed or misrepresented the severity of MPM's financial difficulties to MPM Board members and Endowment Committee members for an extended period of time. These actions included:

- Use of the restricted MPM Endowment Fund (including 21st Century Fund) resources in support of museum operations, in violation of MPM Board policies.
- Submission of reports to the Endowment Committee that included misrepresentations of Endowment Fund activity.
- Inaccurate recording of costs associated with specific exhibits, in violation of Generally Accepted Accounting Principles. In one instance costs associated with a major special exhibit were deferred to the next fiscal year to improve the current year's fiscal 'bottom line.' In another instance, a museum staff person's salary and benefit costs allocated to a special exhibit were grossly overstated and capitalized over the life of the project, again to improve the museum's apparent current fiscal picture.
- Non-compliance with specific restrictions established in a formal agreement by the donor of a large cash contribution, as well as violation of MPM corporate by-laws and of bank-imposed financial restrictions.

- Inappropriate use of National Science Foundation (NSF) grant advances. Requirements for the proper use of advances were violated on occasions when advanced funds were used for museum operations rather than in support of specific NSF projects.

Knowledge and Actions of Former CEO

It is the CFO's contention that he kept the CEO fully informed of MPM's financial situation. He cites, in particular, e-mail correspondence to the CEO beginning in January 2004 that expressed the CFO's concerns, particularly with the lack of private fundraising. The CFO provided us with copies of several e-mails during the period January through July 2004 that included, to varying degrees, concerns about FY2004 cash flows and proposed fundraising projections contained in early drafts of the FY2005 budget (the first budget prepared under the direction of the CEO). Thus, there is clear evidence that the CFO repeatedly expressed concerns to the CEO regarding MPM's financial situation beginning approximately mid-year in FY2004, shortly after the CEO's assumption of duties at MPM.

What is less clear is the degree to which the CFO divulged prior and growing reliance by MPM on the use of its 21st Century Fund to support general museum operations, or the extent to which the CEO recognized this as a problem. For instance, there is no indication that the CFO informed the CEO that the 21st Century Fund—which was strictly limited by MPM Board policy to annual withdrawals of just 3% for general museum operational support—was completely depleted between June 2002 and March 2004 (a liquidation of \$4,353,000). It is also important to note that, while the CFO repeatedly expressed concerns with a fundraising shortfall in FY2004, the magnitude of the shortfall—\$1.7 million according to the CFO with just 45 days remaining in the fiscal year—could hardly be characterized as the primary problem in a year that ended with a deficit of \$6.4 million.

Only the CFO and CEO know the true extent of their mutual understanding of MPM's looming financial crisis during the year preceding its public disclosure. Our review of documentation and interviews with both parties, as well as MPM Board members, leads us to conclude that the CFO clearly raised concerns about MPM's financial condition beginning in early 2004. However, it is equally clear that the CFO had not fully disclosed to the CEO or the MPM Board of Directors the frequent and growing reliance on Board-restricted funds to sustain museum operations. As MPM's financial condition continued to decline throughout FY2004 and FY2005, the CEO did not sufficiently heed the CFO's warnings. Further, as head of the organization, the CEO must accept additional responsibility for a climate, already present upon his arrival, of either suppressing negative news from MPM Board members, or continually tempering negative news with optimism and projections of improvement.

MPM Board Oversight

In our interim report, we concluded that ultimate responsibility for MPM rests with its Board of Directors. Additional audit fieldwork has provided ample evidence that the Board was not fully informed by either the CFO or the CEO, and that the Endowment Committee in particular was indeed misled by the CFO. However, efforts by both the CEO and CFO to omit or minimize adverse financial news would have been exposed by an MPM Board more diligent in exercising its oversight responsibilities.

Corporate boards are responsible for establishing the corporate culture of an organization. In placing complete trust in museum management, the MPM Board failed to adequately scrutinize staff reports and indirectly fostered a corporate culture that discouraged frank discussion of the 'downside' risks associated with the aggressive growth experienced by MPM. This same corporate culture was exhibited by the MPM Executive Committee when it failed to notify Milwaukee County officials of the museum's financial crisis as it unfolded shortly before the Milwaukee County Board of Supervisors voted on the pending \$63 million, 20-year Lease and Management agreement on March 17, 2005.

Factors Leading to MPM's Financial Difficulties

Section 3 of this final audit report provides an analysis of the impact of attendance, fundraising, special projects/exhibits, grants, retail sales, restaurant and catering services, the IMAX Theatre, Discovery World, the Tirimbina Rainforest Center and other items on MPM operations.

A common trait noted throughout our analysis of several MPM cost centers was MPM's failure to adjust revenue projections for subsequent year budgets to recognize actual performance trends. This was particularly true in development of the FY2004 budget, which the CFO prepared while he held the formal title of Chief Operating Officer/Chief Financial Officer, and was acting Chief Executive Officer as well. As previously described, examples of unrealistic budgeting for FY2004 include:

- Retail sales, budgeting a surplus of \$325,000 for an area of operations that had consistently experienced substantial losses. The net operating results for retail sales in FY2004 was \$650,000 below budget.
- IMAX Theatre, budgeting a surplus of \$342,000 for an area of operations that had consistently performed at about break-even levels.
- Grants, with budgeted revenues overstated by approximately \$625,000.

- Special exhibits, with approximately \$2 million in previously recognized *Quest* revenue budgeted for FY2004.

Additional Challenges Facing MPM

In **Section 4** of this final audit report, we discuss additional challenges facing MPM, including the museum's pending offer to purchase space vacated with the anticipated relocation of Discovery World, MPM's ownership of the Tirimbina Rainforest Center in Costa Rica, and the state of the museum's 6.5 million artifacts, owned by Milwaukee County.

We would like to acknowledge the cooperation of MPM staff during the course of our audit. A management response from MPM is attached as **Exhibit 7**.

Background

The Milwaukee Public Museum has been in operation since 1882. In 1976, responsibility for the museum was moved from the City of Milwaukee to Milwaukee County. The County managed the museum until 1992, when operation was transferred to Milwaukee Public Museum, Inc. (MPM). All artifacts and the museum facility have been, and continue to be, the property of Milwaukee County. The Department of Audit monitored the transition of the museum from a public to a private enterprise until December 2001. Since its departure from County administration, MPM has established formal affiliations with subsidiary interests whose activities are included in consolidated financial statements of the core museum operations. These affiliations include Friends of the Milwaukee Public Museum, Inc. (FOM), the Endowment Fund, and the Tirimbina Rainforest Center. *[Note: For FY2005, MPM's independent external auditors determined that FOM is not an appropriate inclusion in MPM's consolidated financial statements, and beginning in FY2005 FOM is not part of MPM's audited financial statements.]* On nearly every measure, the transfer was determined, in 2001, to be a success, particularly regarding MPM's ability to raise private funds. For instance, due to increased private donations and a greater ability to generate revenue, Milwaukee County's share of total revenues for MPM decreased from about 59% in 1991 to less than 23% in 2001.

Milwaukee County officials were notified by the Milwaukee Public Museum, Inc. (MPM) on May 3, 2005 that a newspaper story would be published the next day highlighting a significant negative financial result for fiscal year (FY) 2004 operations. The disclosure of a \$4.1 million reduction in net assets (recently revised to a final audited figure of \$6.4 million) triggered a series of events including:

- Resignations of the MPM Chief Executive Officer, the Chairman of the MPM Board of Directors and the Chairman of the MPM Audit and Finance Committee (the Chief Financial Officer of MPM had resigned on April 15, 2005);
- A decision by Milwaukee County to not execute a new 20-year lease and management agreement;
- Downsizing of MPM staff by approximately 42%, from 269 positions in January 2005 to 157 positions in November 2005.
- Appointment of a five-member Financial Oversight Committee to monitor all MPM financial transactions as a condition of receiving Milwaukee County backing for a \$6 million of credit; and

- Initiation of a Milwaukee County audit.

Our interim report in June 2005 presented an overview of MPM governance and financial management that led to the financial crisis facing the museum. This final report presents, in greater detail, factors that led to MPM's near insolvency in May 2005. This includes an analysis of the impact of attendance, fundraising, special projects/exhibits, grants, retail sales, restaurant and catering services, the IMAX Theatre, Discovery World, the Tirimbina Rainforest Center and other items on MPM operations.

Section 1: MPM's Financial Condition

Based on its most recent audited financial statements, MPM had a FY2004 net asset loss of \$6.4 million.

2004 Financial Condition

As described in our interim report, there have been different interpretations of MPM's financial condition at the end of its fiscal year ending August 31, 2004 (FY2004). Discussions have centered primarily on MPM's financial performance relative to its operating deficit and the change in its net assets. Based on its most recent audited financial statements, MPM had a FY2004 net asset loss of \$6.4 million.

2005 Financial Condition

As of November 22, 2005, MPM's financial statements indicate a continuation of the deteriorating financial trend noted in our interim report, with an anticipated, non-audited net asset loss of \$10.4 million for FY2005. Those same financial statements show MPM had borrowed \$4.5 million from its Endowment Fund, including approximately \$1 million in permanently restricted funds.

It should be noted that MPM's FY2005 financial statements reflect significant negative audit adjustments, many for prior-year accounting entries.

Current Financial Condition

With the assistance of a Milwaukee County-backed credit totaling \$6 million and the addition of the County-appointed Financial Oversight Committee, MPM has established a break-even operating budget for FY2006 totaling \$12.7 million, representing a 42% reduction from its approved FY2005 expenditure budget of \$22.0 million. This break-even budget does not address MPM's substantial long term debt.

Financial Trends

This section of our final audit report recaps the overall financial trends identified in our interim report, and updates those trends with additional data obtained for FY2004 and FY2005.

Key Financial Trends

We have selected key financial indicators to present an overview of the general financial health of MPM, beginning in 1999.

We have selected key financial indicators to present an overview of the general financial health of MPM, beginning in 1999. We have selected 1999 as a beginning point because, as noted in the **Background** section of this report, there was a consensus that MPM had successfully transitioned from a public institution to a public/private partnership. In addition, 1999 was the first year of MPM's last major capital campaign, the 21st Century Fund. This overview analysis, originally presented in our interim report, focuses on general financial trends. Some of the underlying causes of those trends are more thoroughly examined in the remaining sections of this final audit report.

To understand the significance of these selected financial trends, it is important to understand several concepts and definitions:

- **Cash and Cash Equivalents.** Cash and other highly liquid investments with maturities of three months or less. This provides insight into MPM's ability to meet cash outlay requirements, such as payroll and vendor invoices.
- **Contributions and Memberships.** Includes revenue raised from memberships to Friends of the Museum and contributions over and above the two basic levels of membership. All proceeds are classified as unrestricted and can be used to support all operations and programs.
- **Net Revenue & Support from Operations.** Funds available after revenues (includes admissions, IMAX, retail and restaurant sales), unrestricted contributions and grants are netted against operating expenses. These funds are unrestricted and can be used for any purpose.
- **Line of Credit.** Funds normally borrowed for a short period of time (under one year) to cover cash shortages.

- **Property and Equipment.** Major expenditures for construction, building additions and improvements, as well as furnishings and equipment.
- **Long Term Liability.** Primarily the outstanding debt obligations from the issuance of bonds.
- **Unrestricted Assets.** Funds and other gifts for which no specific restrictions have been placed upon their use. Indicates the availability of funds available to support any aspect of the museum's operations.
- **Temporarily Restricted Assets.** The balance of funds, investment proceeds and other gifts, the use of which has been specifically restricted for certain purposes. For instance, a donation may be made specifically for use in supporting the museum's *Puelicher Butterfly* exhibit. When the purpose of the restriction is met, temporarily restricted assets are reclassified as 'unrestricted,' and they may be counted as revenue towards MPM's operating 'bottom line.' This category indicates whether there are funds available to complete projects that are in progress or to start new projects.
- **Temporarily Restricted Contributions.** A subset of temporarily restricted assets, contributions constitute the funds and other gifts donated in the particular year they were pledged that have specific designations. This subset does not include certain items, such as investment proceeds, contained in the category of temporarily restricted assets.
- **Increase/Decrease in Total Net Assets.** This is what is often referred to as the 'bottom line,' the change in the organization's total assets minus total liabilities. The level of total net assets indicates the level of resources available to help meet short and long term obligations.
- **Total Private Fundraising** is obtained by combining the categories of **Contributions and Memberships** and **Temporarily Restricted Contributions**. It includes both unrestricted funds in support of current and future operations, as well as temporarily restricted gifts that entail future obligations and affect future cash flows.

Table 1 shows selected key financial trends for MPM from 1999 through 2005. The information is presented from the consolidated financial statements of MPM, Inc., which includes not only museum operations, but also activity from subsidiary components such as the Endowment Fund and Tirimbina Rainforest Center.

Table 1
MPM, Inc.
Selected Financial Indicators
FY1999—FY2005
(In Millions)

	<u>FY1999</u>	<u>FY2000</u>	<u>FY2001</u>	<u>FY2002</u>	<u>FY2003</u>	<u>FY2004</u>	<u>FY2005</u>
Cash & Cash Equivalents	\$5.4	\$5.1	\$5.7	\$2.6	\$0.6	\$0.5	\$1.7
Contributions & Membership*	2.8	2.7	3.3	3.5	4.4	2.6	3.2
Net Revenue & Support	(0.3)	0.2	0.2	(1.0)	2.1	(3.9)	(8.7)
Line of Credit	0.3	0.5	0.7	1.0	1.5	2.3	0
Property & Equipment	10.5	20.3	23.8	26.6	28.3	29.9	29.8
Long Term Liability	14.1	18.0	17.1	17.9	17.6	17.9	24.3
Temporarily Restricted Assets	9.7	13.2	14.6	15.2	3.7	1.1	2.0
Temporarily Restricted Contributions*	6.6	3.9	2.8	1.7	1.4	0.6	1.5
Total Net Assets	10.1	14.2	16.1	14.3	12.8	6.4	(4.0)
Inc/Dec Total Net Assets	5.4	4.1	1.9	(1.8)	(1.5)	(6.4)	(10.4)
Percent Change Total Net Assets	N/A	41%	13%	-11%	-10%	-50%	-163%

*Total Private Fundraising \$9.4 \$6.6 \$6.1 \$5.2 \$5.8 \$3.2 \$4.7
(Combined Categories of 'Contributions and Memberships' and 'Temporary Restricted Contributions')

Source: MPM audited consolidated financial statements (1999—2004); unaudited consolidated financial statements (as of 11-22-05).

Based on our review of year-end audited financial statements for 1999—2004, unaudited financial statements for 2005 and discussions with MPM fiscal staff, we make the following observations of MPM's general financial health.

- **Cash and Cash Equivalents** at year-end shows a precipitous decline since fiscal year-end 2001, from \$5.7 million to just \$500,000 in FY2004. Implementation of a survival turnaround plan, and with the aid of \$6 million in County-guaranteed loans, MPM's cash position increased to \$1.7 million at fiscal year-end 2005.
- **Contributions and Memberships** reflect a substantial drop from \$4.4 million in FY2003 to \$2.6 million in FY2004, but showed improvement in FY2005, rebounding to \$3.2 million.
- **Net Revenue and Support**, which is a key indicator to show funds generated from operations, shows a precarious margin of profitability from FY1999—FY2001, with a small loss followed by two years of small surpluses. This indicator reflects a drain on resources in three out of the next four years, with mounting losses culminating in a deficit of \$8.7 million for FY2005. The one exception to this declining trend, FY2003, was significantly bolstered by a change in accounting rules for MPM. The change freed up approximately \$8.1 million of previously restricted funds (this

An accounting change in FY2003 provided approximately \$4 million that had the effect of masking mounting losses from core museum operations.

is a major portion of the reduction of **Temporarily Restricted Assets**) and provided approximately \$4 million that had the effect of masking mounting losses from core museum operations.

The general deterioration of MPM's financial condition is reflected in four consecutive years of a 'bottom line' reduction in **Total Net Assets**, from \$16.1 million in FY2001 to a negative (\$4.0) million in FY2005.

- **Line of Credit** steadily increases over the period from FY1999 (\$300,000) to FY2004 (\$2.3 million). This reflects the increasing reliance of MPM on outside creditors to meet basic cash flow requirements. In FY2005, MPM's line of credit was reduced to zero when MPM added \$6.5 million of credit (\$6 million of which is backed by Milwaukee County) in the form of Notes Payable, or long-term debt, as part of its turnaround plan.
- **Property and Equipment** increased from \$10.5 million in FY1999 to \$29.8 million in FY2005. This increase reflects the dramatic growth in physical assets, such as building improvements and special exhibits, acquired by MPM during the period. Examples of these acquisitions include the construction of the IMAX Theater, the *Puelicher Butterfly* exhibit, and the *Bugs Alive* exhibit. Much of this growth was financed with restricted contributions and a portion of MPM's long term liability.
- **Long Term Liability** had remained relatively steady during the period FY2000 through FY2004 (in the \$17-\$18 million range), but increased sharply in FY2005, to \$24.3 million.
- **Temporarily Restricted Contributions**, show a dramatic decline over the period, from its peak in FY1999 of \$6.6 million, to just \$600,000 in FY2004. FY2005 shows improvement in this area, with an increase to \$1.5 million.
- The combination of deficits from core museum operations, aggressive growth financed by long-term debt and contributions, and the failure to sustain an adequate stream of new contributions, resulted in the general deterioration of MPM's financial condition. This is reflected in four consecutive years of a 'bottom line' reduction in **Total Net Assets**, from \$16.1 million in FY2001 to a negative (\$4.0) million in FY2005.
- The **Increase/Decrease in Total Net Assets** trend shows that the deterioration has accelerated dramatically in FY2004 and FY2005. In FY2002, MPM experienced a loss of \$1.8 million; in FY2003, it lost another \$1.5 million; in FY2004, the loss mounted to \$6.4 million; in FY2005, MPM lost another \$10.4 million.
- **Total Private Fundraising** declined from its peak of \$9.4 million in FY1999 to \$3.2 million in FY2004. A steady stream of private donations was initially intended to pay down long-term debt and to establish a permanent endowment from

which to support special exhibits and operations. However, this precipitous decline in contributions, in concert with MPM's aggressive acquisition of **Property and Equipment**, has left the museum unable to meet the primary goal of paying down long-term debt, let alone establish a permanent endowment. While private fundraising improved to \$4.7 million in FY2005, this total was far short of the amount necessary to sustain museum operations.

In our interim report, we noted that the consolidated financial statements of MPM, Inc., which include the affiliated entities of the Tirimbina Rainforest Corporation, Friends of the Milwaukee Public Museum (through FY2004) and the Endowment Fund, have in some ways disguised the extent of the drain that core museum operations has placed on the corporation. We noted that the consolidated statements had the effect of masking the fact that MPM, as of August 31, 2004, had borrowed \$761,000 from the Endowment Fund. Updated through August 31, 2005, MPM had borrowed \$4.5 million from its Endowment Fund, leaving a fund balance of just \$387,000.

A distinct trend of declining contributions and operational losses, at the same time that MPM was pursuing a strategy of growth, brought the institution to a crossroads at fiscal year-end 2002. The disparate trends continued at an accelerating pace through FY2004 and FY2005, culminating in the financial crisis publicly acknowledged in May 2005.

Section 2: Financial Reporting and Oversight

Vesting responsibility for administration, operations and finance in one person was particularly problematic given the broad power to manage MPM's funds.

In our interim report, we concluded that ultimate responsibility for MPM operations rests with its Board of Directors. We also noted that day-to-day administration is clearly the responsibility of the Chief Executive Officer (CEO), and that in this case, the MPM Board also placed significant reliance on the Chief Operating Officer/Chief Financial Officer (CFO). This individual, who had direct reporting lines to both the CEO and to the Board of Directors, was responsible for finance, admissions, security, facilities, human resources, technology and business development.

We also noted in our interim report that vesting responsibility for administration, operations and finance in one person was particularly problematic given the broad power to manage MPM's funds. This authority, which included the ability to direct the sale and disbursement of Endowment Fund assets, was granted by Board action in April 2002. While Endowment Committee policy established parameters and required the CFO to submit annual budgets identifying planned expenditures from the Endowment Fund, the CFO was authorized to effect transactions without the benefit of specific approvals or a countersignature.

In our previous report, we noted that while MPM Board meeting minutes contained clues about the deterioration of MPM's financial condition, it did not appear that the severity of the situation was ever disclosed directly by management or probed into by Directors until early in 2005.

Since our June 2005 report, we have reviewed MPM financial transactions, management reports provided to the MPM Board of Directors, and various related correspondence during the period spanning MPM's fiscal years 2002 through 2005, in greater detail. In addition, during the course of our audit we have

We believe the former CFO engaged in a series of actions that concealed or misrepresented the severity of MPM's financial difficulties for an extended period of time.

interviewed Endowment Committee members, MPM Board members and both present and former MPM staff members. Based on our review, we believe the former CFO engaged in a series of actions that concealed or misrepresented the severity of MPM's financial difficulties to MPM Board members and Endowment Committee members for an extended period of time. These actions included:

- Use of the restricted MPM Endowment Fund (including 21st Century Fund) resources in support of museum operations, in violation of MPM Board policies.
- Submission of reports to the Endowment Committee that included misrepresentations of Endowment Fund activity.
- Inaccurate recording of costs associated with specific exhibits, in violation of Generally Accepted Accounting Principles. In one instance costs associated with a major special exhibit were deferred to the next fiscal year to improve the current year's fiscal 'bottom line.' In another instance, a museum staff person's salary and benefit costs allocated to a special exhibit were grossly overstated and capitalized over the life of the project, again to improve the museum's apparent current fiscal picture.
- Non-compliance with specific restrictions established in a formal agreement by the donor of a large cash contribution, as well as violation of MPM corporate by-laws and of bank-imposed financial restrictions.
- Inappropriate use of National Science Foundation (NSF) grant advances. Requirements for the proper use of advances were violated on occasions when advanced funds were used for museum operations rather than in support of specific NSF projects.

Use of Endowment Fund Resources

In 1999, the MPM Board of Directors adopted a policy for use of its 21st Century Fund that restricted its use for museum general operations support to 3% of the fund balance until such time as the balance reached parity with outstanding bond debt, increasing to 5% of the fund balance thereafter. A more comprehensive *Statement of Investment Objectives, Policies and Guideline for the Milwaukee Public Museum Endowment Fund* was approved by the MPM Endowment Committee on April 25,

2001. This document laid out a strategy for combining the 21st Century Fund with the MPM Endowment Fund and, ultimately, a smaller endowment maintained by Friends of the Milwaukee Public Museum, and reaffirmed the maximum 5% limit on annual support for museum operations. On May 17, 2001, the full MPM Board approved co-mingling the funds in a combined investment pool, commonly referred to as the museum Endowment Fund. An updated *Milwaukee Public Museum Endowment Fund Spending Policy* was approved by the MPM Endowment Committee on July 10, 2002, which established policy for management and use of the Endowment Fund. That policy continued the 3% and 5% limits on withdrawals for support of museum operations, based on the previous rolling three-year average total asset value of the combined investment pool fund balance.

Direct administrative expenses related to managing the combined investment pool were to be paid from the 3% and 5% limits, respectively, with the remainder of the 3%/5% withdrawals available for general museum operations. Specific program expenditures from temporarily restricted funds, and from proceeds of permanently restricted funds, within the original Endowment Fund could be withdrawn separately. Withdrawals for each of these three purposes (direct administrative expenses, program expenses and general museum operations support) were subject to approval by the Endowment Committee in the form of an annual budget submission.

Yet, from the period July 10, 2002 through July 28, 2005 (covering all Endowment Committee meetings throughout Fiscal Years 2003 through 2005), the CFO submitted just one Endowment Fund budget for approval, that being a FY2003 budget submitted on July 10, 2002—the day the spending policy was adopted. Annual operating budgets submitted by the CFO to the Audit and Finance Committee, as well as to the MPM Board, contained single line items identified as “temporarily

Withdrawals totaling \$10.9 million were made from the Endowment Fund during the period June 2002 through March 2005, including approximately \$7.2 million for which no Endowment Committee authorization was obtained.

restricted income” and “temporarily restricted expense” but did not identify specific expenditures, did not account for all Endowment Fund expenditures, and did not comply with the Endowment Committee policy.

Despite the CFO's general lack of compliance with required annual budget submissions, and in violation of the annual 3% support limit, withdrawals totaling \$10.9 million were made from the Endowment Fund during the period June 2002 through March 2005. This included approximately \$7.2 million for which no Endowment Committee authorization was obtained. Of the \$3.7 million of withdrawals authorized by the Endowment Committee during that period, just \$251,200 was identified in advance through submission of an annual budget. All other withdrawals receiving authorization were approved after the fact. Records at MPM show that most of the withdrawals were effected via e-mail by the former MPM Controller, a direct report to the CFO. According to the former Controller, the withdrawals were typically made based on verbal directives from the CFO, and occasionally from verbal directives from the CEO. The CEO noted that the only times he gave such a directive was after the CFO's departure, and only then with the advanced approval of both the Endowment Committee and the Executive Committee.

With the withdrawal of \$500,000 from the combined investment pool in March 2004, the MPM had exhausted the resources of the 21st Century Fund in its entirety and had effectively ‘dipped into’ the Endowment Fund. In March 2005, the withdrawal of Endowment assets included both temporarily and permanently restricted funds.

Misrepresentations of Endowment Fund Activity

MPM's use of Endowment Fund resources without the explicit knowledge or approval of the Endowment Committee was accompanied by inaccurate or misleading reports by the CFO.

For example, a letter from the CFO to the Endowment Committee dated May 16, 2003, (see **Exhibit 2**) contained several inaccuracies and misrepresentations with respect to the fund performance for the period June 30, 2002 through May 31, 2003. *[Note: while a table presented by the CFO indicated balances as of May 31, 2003 the date of the letter and the fund balance indicated is consistent with an April 30, 2003 end date.]* Specifically:

- The CFO partially accounted for a reduction in funds invested of \$1.9 million between August 31, 2002 and May 31, 2003 [sic] by noting \$750,000 was held in cash at the M&I Bank in support of a Letter of Credit in regards to the Quest for Immortality exhibit. We have verified with both the Marshall and Ilsley Bank and the Marshall and Ilsley Trust Company that no cash account in the amount of \$750,000 was maintained for this or any other purpose.
- The CFO provided two figures that, combined, identified net realized and unrealized losses on the fund for the 11 month period [sic] as (\$643,877). Internal MPM records show the actual fund performance for the period to be a net decrease of (\$131,353). An arithmetic error, appearing in two separate lines of a four-line table contained in the CFO's letter, inflates the magnitude of this misstatement from about \$510,000 to more than \$600,000.
- In the letter, the CFO listed the balance as of June 30, 2002 for "funds invested" as \$8,800,570. MPM records show the balance as of that date to be \$8,290,550, or more than one-half million dollars less than the figure reported by the CFO.
- The CFO identified \$1.1 million in bond payments, as well as \$61,435 in bank service fees and Trust withdrawals. Therefore, in the letter to the Endowment Committee, the CFO reported a total of \$1,161,435 in withdrawals from the Endowment Fund. According to our review of MPM internal accounting records, actual withdrawals from the Endowment Fund into the MPM operating fund during the time period June 30, 2002 through April 30, 2003 totaled \$2,024,000.

In summary, the CFO was attempting to explain a reduction of more than \$2 million in the Endowment Fund balance during the prior eight months. With the figures presented to the Endowment Committee in his letter of May 16, 2003, the CFO accounted for this significant reduction by:

Taken in its entirety, the May 16, 2003 letter from the CFO to the Endowment Committee presents a misleading, inaccurate account of the combined investment pool activity for the period June 30, 2002 through April 30, 2003.

- Claiming to have set aside \$750,000 in cash that did not exist.
- Overstating market losses on the portfolio by more than \$600,000.
- Understating Endowment Fund withdrawals by \$860,000.

Included in the figures provided by the CFO was a total of \$1,796,000 identified as "Restricted Funds (Grants)." The CFO could not recall why the grants total was included in the letter. He speculated that it may have represented funds available to MPM and that the figure may have been included in the letter based on a question from an Endowment Committee member. The source of this grant total is not clear from MPM's internal accounting records, nor is it clear why this figure is included in a report of Endowment Fund performance. Clearly, it is inaccurate to include this figure as funds, separate from the "funds invested" line item, under the purview of the Endowment Committee during the time period addressed in the CFO's letter. Taken in its entirety, the May 16, 2003 letter from the CFO to the Endowment Committee presents a misleading, inaccurate account of the combined investment pool activity for the period June 30, 2002 through April 30, 2003.

Another example of misrepresentations by the CFO occurred in a letter dated June 4, 2004 from the CFO to the Endowment Committee. In that letter, the CFO stated:

"The fund is \$1 million lower than our previous quarter reflecting the transfer of funds of \$500,000 for the final payment to M&I for bond reduction, \$100,000 of bond reduction on the IMAX bonds and a \$300,000 reduction in fund performance."

That statement contains two significant misrepresentations:

- MPM did not make a \$500,000 bond reduction (i.e., payment of principle) payment to M&I during the time period identified.
- According to internal MPM accounting records, during the January 1, 2004 through March 31, 2004 time period covered

in the report, actual fund performance was a net gain of \$219,274, not the \$300,000 loss reported by the CFO, a discrepancy of more than \$500,000.

Another example of inaccurate or misleading reports by the CFO to the Endowment Committee is a report dated September 10, 2004 (see **Exhibit 3**). The report begins with the following paragraph:

“For the period ending 06/30/2004, total funds available including investible funds of \$4.6 [million] with cash holding of \$1.1M. The total of \$5.7M as of June was equal to the previous quarter....”

Similar to the CFO’s May 16, 2003 assertion of holding \$750,000 in cash, we verified with MPM’s financial institutions that the museum did not, in fact, have cash of \$1.1 million as of June 30, 2004. In the same report of September 10, 2004, the CFO stated, “No draws or requests for draws for trust activity were made for the six month period.” He continues in the following paragraph, “\$500,000 were drawn from the investible funds as a hedge against making the covenants for 08/31/2004.”

It is not clear from the report whether the \$500,000 draw from the Endowment Fund was made during the first six months of the year, the period selected for reporting by the CFO in the initial paragraph, or during the two months following that period. In either event, the CFO neglected to report a total of \$1.75 million was withdrawn from the fund during the period January through June 2004. Assuming the \$500,000 withdrawal referenced by the CFO pertained to the January through June period, and taking into account a deposit into the fund of \$250,000 from museum operations, the CFO failed to report a net withdrawal from the Endowment Fund of \$1 million.

It was not until its meeting on January 28, 2005 that the CFO clearly indicated to the Endowment Committee that MPM had made withdrawals outside policy restrictions from the

Endowment Fund for museum operations. Minutes from that meeting state:

“[Investment advisor] reviewed the November 30 investment summaries that reflected the first quarter of the MPM fiscal year.... \$1.4M was withdrawn during the quarter and returned to the fund in December.”

However, our review of internal MPM accounting records confirms that while \$1,405,000 was withdrawn from the Endowment Fund during the first quarter of FY2005, as stated in the meeting minutes, no funds were deposited back into the fund in December. The museum staff member that prepared the minutes stated she was unsure who made the comment that \$1.4 million was returned to the fund, further stating that the placement of the comment in the minutes did not necessarily mean the statement was made by the investment consultant.

According to the consultant, he could not possibly have made the statement, because the MPM Endowment Fund was not his account. Rather, the consultant was filling in for a colleague that day. Thus, the CFO was the only person in attendance at the meeting with the knowledge to make a statement concerning the alleged return of \$1.4 million to the Endowment Fund. The consultant's recollection was that the CFO made a statement identifying a need to withdraw the funds due to unexpected health care costs, and that the CFO had stated that either the funds had been replaced, or would soon be replaced. The CFO told us he did not make the statement regarding the withdrawal and return of the \$1.4 million to the Endowment Fund.

Other portions of the minutes from the January 28, 2005 Endowment Committee meeting are consistent with the consultant's recollection. The minutes attribute the CFO as stating:

“There has been a need during the last quarter to withdraw approximately \$1M from the Endowment

Fund for working capital. This was due in part to large health care costs. The first three to four months of the fiscal year are historically lowered income months.”

It should also be noted that the individual who prepared the minutes stated she always prepared draft minutes for the CFO’s review, to ensure that she had properly interpreted comments made at Endowment Committee meetings. The staff person said that the CFO made no corrections to the minutes for this meeting.

As reported in our interim audit report, it was at this same Endowment Committee meeting on January 28, 2005 that the Committee was misinformed as to the current balance of the Endowment Fund. The investment advisor reported on a total portfolio market value of \$6.4 million and distributed a percentage breakdown of the funds. However, the document shared with the committee was a **December 2002** summary—in other words, the committee was briefed on two-year old data. The actual portfolio, as of **December 2004**, was approximately \$2.5 million, or \$3.9 million less than reported to the committee. According to Endowment Committee members present at the meeting, the December 2002 date was questioned at the time, and the committee was assured by the investment advisor that the date was merely a clerical error, that the data was indeed current. Although he was present at the meeting, the CFO did not point out the error to the committee.

In our interim report, we stated that “Failure to point out this serious error is an indication that staff was either not diligent in their service to the committee or they did not wish the actual portfolio balance to be known.” Our subsequent identification of frequent withdrawals from the Endowment Fund for museum operations dating back to June 2002, as well as the inaccuracies and misrepresentations contained in reports to the Endowment Committee by the CFO as identified in this report, sheds

additional light on the nature of the CFO's silence at the January 28, 2005 Endowment Committee meeting.

Our review of minutes and interviews with Endowment Committee members reinforce our interim report conclusion that there was a general lack of sufficient scrutiny on the part of the Endowment Committee.

Endowment Committee Oversight

During our review of documents prepared by the CFO for review by the Endowment Committee during the period March 29, 2001 through February 7, 2005, we identified numerous instances of confusing presentations, including the mixing of calendar year and fiscal year timelines, illogical column headings and dates, as well as apparent contradictions that would appear to have prompted probing questions from a diligent oversight board. Our review of minutes and interviews with Endowment Committee members reinforce our interim report conclusion that there was a general lack of sufficient scrutiny on the part of the Endowment Committee. It was under the general oversight of the Endowment Committee that the Endowment Fund was virtually depleted, from a balance of \$8.5 million in April 2002 to \$387,000 as of August 31, 2005.

To enhance its oversight of Endowment Fund activity, we recommend the MPM Endowment Committee:

1. *Obtain quarterly bank/investment statements summarizing Endowment Fund activity for verification purposes.*

Inaccurate Recording of Costs

Generally Accepted Accounting Principles allow for the spreading of costs associated with creating a capitalized asset (e.g., an asset whose value is depreciated over a number of years) across the useful life of the asset. For instance, in creating a permanent exhibit for the museum, staff costs associated with the necessary research, as well as the fabrication and construction of the physical display, can be spread out over the expected life of the exhibit, typically 35 years.

We found that the CFO overstated the amount of capitalized salaries and benefits of MPM employees allocated to three permanent exhibits (*Bugs Alive*, *Exploring Life on Earth*, and *Bullet Ants*) in both FY2002 and FY2003. By overstating costs to be spread over future years, current expenses are understated, thus having the effect of improving the appearance of MPM's current 'bottom line.'

According to MPM staff whose salary and benefit costs were capitalized, there was no system in place to capture the number of hours worked on preparation of the exhibits. The CFO acknowledged that there was no formal process for estimating staff time allocations in FY2002 and FY2003. However, he stated that a variety of measures were employed to estimate staff time allocated to various exhibits, including staff work plans, time card data, work orders and direct observation. Yet, staff confirmed that the CFO did not discuss with them the basis for the estimate of time allocated to the various exhibits. In one instance, an MPM staff member told us she estimates, based on personal calendar notes, she spent approximately 280 hours in preparation of the permanent exhibit *Bugs Alive*. Based on a spreadsheet modified by the CFO for purposes of allocating salary and benefit costs, the CFO capitalized the entire year's personnel costs for this individual to the *Bugs Alive* exhibit in FY2002.

The total impact of these improper cost allocations was to improve the apparent 'bottom line' for MPM operations by \$525,700 in FY2002 and by \$189,600 in FY2003.

MPM entered into a donor agreement that would enable the museum to acquire a planetarium system.

Non-Compliance with Donor and Bank Restrictions

On November 12, 2004, MPM management, with Board approval, entered into a donor agreement. The agreement would enable MPM to acquire a planetarium system that would facilitate conversion of the IMAX Theatre to a dual-use planetarium/movie venue. The donor agreed to provide \$1.8

million over a five-year period. In the grant agreement, MPM acknowledged that the donation was a restricted gift, and also agreed to rename the facility, adding the donor's name to the planetarium venue, upon installation of the equipment. An initial pledge installment of \$500,000 was made upon the signing of the agreement, while the remaining \$1.3 million was to be provided in annual payments of \$260,000 over the next five consecutive years.

The donor agreement included a sales agreement draft from a planetarium system manufacturer, which guaranteed a \$1.8 million purchase price for the system if the agreement was signed by December 17, 2004. MPM signed the sales agreement, which included an optional feature for \$75,000, on December 6, 2004. The sales agreement required MPM to make a down payment of 30% upon signing (\$562,500), an additional 30% six months after the signing, and an additional 30% prior to shipment of the system. The remaining 10% was payable upon MPM's acceptance of the system.

A spokesperson for the donor indicated the donor believed MPM would use the \$500,000 for the down payment and the remaining \$1.3 million of the system would be financed through a financing lease arrangement. According to the spokesperson, the donor believed additional costs, including optional equipment, optional warranties, site preparation, shipping and insurance, would be financed with MPM operating funds.

However, both the CFO and the CEO signed a seven-year, \$2.75 million financing lease in January 2005. Over the seven-year term of the lease, MPM was responsible for making total payments of \$3,465,000. While MPM's bylaws require all items of indebtedness to be approved by the Board of Directors, we found no Board discussion or approval for the financing arrangement in the Board minutes.

The donor's spokesperson told us that, upon receipt of the signed financing lease agreement, the donor was upset to discover MPM had financed \$2.75 million instead of \$1.3 million. According to MPM's accounting records, the initial \$500,000 donation was never restricted or used as part of the down payment for the planetarium system. Instead, the money was used for general museum operations. The former CFO told us that the \$500,000 was not restricted because it was anticipated that MPM's expenditures for related preparatory work and consultant fees would easily exceed \$500,000 for the year.

Currently, MPM's new management is in the process of revising the original agreements with the donor, planetarium system manufacturer, and the financing lease company.

We recommend that MPM management:

2. *Obtain MPM Board approval for any indebtedness as required by the bylaws.*
3. *Ensure donor restricted gifts are not used for purposes other than the donor intended purpose.*
4. *Finalize, for MPM Board approval, any revisions to the original agreements with the donor, planetarium system manufacturer, and the financing lease company in accordance with donor wishes.*

An instance in which the MPM did not adhere to bank restrictions relates to a significant private donation in 1999. As part of a bank agreement to extend the amount of a line of credit to MPM, the museum was required to dedicate the proceeds of a \$3 million pledge from a charitable foundation to pay down bond debt associated with the museum's construction of the permanent exhibit, the *Puelicher Butterfly* exhibit. As part of the bank agreement for the line of credit, MPM was required to make bond reduction payments within 13 months of receiving the donations. **Table 2** shows the dates the charitable foundation's

donations were received by MPM, as well as the dates that MPM made the related bond reduction payments.

Table 2
Charitable Foundation Donation Schedule
and Related MPM Bond Reduction Payment Schedule

<u>Donation Amount</u>	<u>Date of Donation</u>	<u>Bond Payment Due Date</u>	<u>Actual Date of Bond Payments</u>	<u>Payment Amount</u>
\$500,000	05/14/99	06/14/00		
\$500,000	10/15/99	11/15/00	09/30/00	\$500,000
\$500,000	09/26/00	10/26/01	03/01/01	\$500,000
\$500,000	05/23/01	06/23/02		
\$500,000	07/10/02	08/10/03	09/27/02	\$1,000,000
\$500,000	08/14/03	09/14/04		
			03/31/05	<u>\$1,000,000</u>
Total	\$3,000,000			\$3,000,000

Note: Initial bond reduction payment due dates were extended at various times during the period.

Source: MPM donor gift and bank agreements.

While each of the donations was received as scheduled, MPM did not have sufficient funds on hand to make all required bond reduction payments. Consequently, MPM had to obtain bank covenant waivers and an additional line of credit to make the April 1, 2005 required bond reduction payment.

Inappropriate Use of NSF Grants

The majority of grant funding at MPM is received from the National Science Foundation (NSF). Since 1977, NSF has awarded MPM 24 grants totaling over \$4.6 million. NSF grants may be tied to a specific researcher; therefore, if funds are advanced and the researcher leaves MPM the funds may need to be transferred to the researcher.

According to the NSF grant policy manual, NSF payments may be made in advance of work performed or as a reimbursement for work performed. The policy states advances may be requested provided that the following conditions exist:

- Funds for the project period have been obligated by a Grants Officer in the form of a signed grant;
- The grantee has established or demonstrated to NSF the willingness and ability to establish written procedures that will minimize the time elapsing between the transfer of funds from the US Treasury and their disbursement by the grantee; and
- The grantee's financial management system meets the standards for fund control and accountability prescribed in Office of Management and Budget (OMB) Circular A-110.

Further, the policy states "such requests should be limited to the minimum amounts needed and be timed to meet the anticipated cash requirements for allowable charges to active NSF projects." In addition, "grantees shall maintain advances of NSF funds in interest bearing accounts as specified in GPM 443, Interest Earned on Advance Payments."

MPM was not in compliance with the NSF grant policy manual.

MPM was not in compliance with the NSF grant policy manual or the A-110 OMB compliance requirements for federal funds. The violations included spending funds on unallowable costs, advancing funds without limiting them to the minimum amounts needed for allowable costs, and not placing advanced amounts in interest bearing accounts.

During our review of the advanced NSF funds, we found MPM had received advances of \$250,000 in FY 2003 and \$235,500 in FY 2004. In August 2004, it was apparent that all NSF funds had been advanced. While a portion of the advanced funds may have been spent appropriately, a significant portion of the advanced funds were used for general museum operations, which is prohibited by grant requirements. Two NSF grants were tied to researchers employed at MPM. The employees left MPM in July 2004 and September 2004; therefore, the advanced NSF funding needed to be transferred to the researchers. The total amount that had been advanced and not spent on grant-related expenditures was \$221,226. The transfer was not completed until January 2005 due to cash flow problems. Further, internal

documents showed that the CFO attempted to receive additional NSF funds to cover the \$221,226.

In August 2005 MPM returned \$25,688 to NSF at the request of NSF. NSF noted that MPM had held excess cash on hand for up to 415 days. Further, NSF referenced MPM to the NSF grant policy manual, which states, “the timing and amount of cash advances shall be as close as is administratively feasible to actual disbursements for direct program costs and the proportionate share of any allowable indirect costs.”

Cash flow problems at MPM led to inappropriate advancing and spending of federal funds on general museum operations.

Based on our review, it appears that cash flow problems at MPM led to inappropriate advancing and spending of federal funds on general museum operations, in violation of the grant requirements. Since the advanced funds were used to address cash flow problems, MPM was unable to properly place advanced funds in interest bearing accounts as required by Federal regulations and was unable to transfer funds when researchers left the museum.

To avoid potential sanctions from federal funding sources, we recommend that MPM:

5. *Discontinue the practice of advancing federal funds for unallowable costs.*
6. *Draw advances of federal funds in accordance with the NSF grant policy manual.*

Knowledge and Actions of Former CEO

In our interim report, we stated that hands-on management of detailed financial activities by the former President/CEO was not evident in internal correspondence until February 19, 2005. At that point, concerns about cash flow resulted in a plan by the CEO to bring operations into fiscal balance. One month later, on March 13, 2005 a recent payroll overdraft at the bank prompted a freeze in expenditures, all credit cards were collected, a ‘workout’ consultant was pursued at the bank’s urging and

accounts payable were put under aggressive management. It was also noted that the new agreement with Milwaukee County was essential to MPM's survival. Finally, the plan also included the need for the County to advance the payment under the current agreement by two days so MPM could make a \$1.1 million debt payment.

It is the CFO's contention that he kept the CEO fully informed of MPM's financial situation. He cites, in particular, e-mail correspondence to the CEO beginning in January 2004 that expressed the CFO's concerns, particularly with the lack of private fundraising. The CFO provided us with copies of several e-mails during the period January through July 2004 that included, to varying degrees, concerns about FY2004 cash flows and proposed fundraising projections contained in early drafts of the FY2005 budget (the first budget prepared under the direction of the CEO).

An e-mail dated July 18, 2004 (see **Exhibit 4**) appears to contain the strongest expression of concern on the part of the CFO to the CEO, including the following:

"Communication is also a problem. In April, when I wrote up the 6 month analysis, I knew we were not going to make it in Development given the terrible result in December. When we "revised" the report to the Board, we basically said we would make it up. We told that again to them last month. We need to decide how that gets communicated. This is your call. But, in the future, you may want to consider advising this board when something negative occurs early rather than later. This is an issue of credibility for both of us."

Later in that same e-mail, under the heading "Solutions," the CFO says to the CEO:

"...I think three things need to happen. First, tell the Board before I do so at the September meeting. Maybe Tuesday is a good starting point. But you need to decide this for yourself."

Next, you need to get more involved with [the Sr. Vice President of Development] on Development, specifically reporting and performance for cash flow. He is not used to this environment and is also only here 4 days a week. Also, assess your staff in this area carefully. They are average at best. They are trying to overachieve and the results are showing.

Finally, we need to re-tool the 2005 budget. [The Sr. Vice President of Development] is asking for a week to see if that is needed. I don't need a week. The budget is flawed. So the sooner the better for revisions."

There is clear evidence that the CFO repeatedly expressed concerns to the CEO regarding MPM's financial situation.

Thus, there is clear evidence that the CFO repeatedly expressed concerns to the CEO regarding MPM's financial situation beginning approximately mid-year in FY2004, shortly after the CEO's assumption of duties at MPM.

What is less clear is the degree to which the CFO divulged prior and growing reliance by MPM on the use of its 21st Century Fund to support general museum operations, or the extent to which the CEO recognized this as a problem. For instance, there is no indication that the CFO informed the CEO that the 21st Century Fund—which was strictly limited by MPM Board policy to annual withdrawals of just 3% for general museum operational support—was completely depleted between June 2002 and March 2004. The 21st Century Fund, which totaled \$4,353,000 on April 30, 2002, was intended to remain invested and grow with the primary purpose of repaying long-term MPM bond debt. Further, it appears that the CFO sometimes referred to funds restricted by Board policy (the combined investment pool comprised of the 21st Century Fund, the MPM Endowment Fund and funds of Friends of the Milwaukee Public Museum) as "reserves" in communications to the CEO. It is also important to note that, while the CFO repeatedly expressed concerns with a fundraising shortfall in FY2004, the magnitude of the shortfall—\$1.7 million according to the CFO with just 45 days remaining in the fiscal year—could hardly be characterized as

the primary problem in a year that ended with a deficit of \$6.4 million.

The CEO stated that he considered the CFO's concerns exaggerated, believing that the museum had reserves upon which to draw.

The CEO acknowledged to us that the CFO had informed him of cash flow problems at MPM, and had particularly expressed concerns with a lack of private fundraising. However, he stated that he considered the CFO's concerns exaggerated, believing that the museum had reserves upon which to draw, and was not cognizant of the severity of the museum's financial condition until the aforementioned difficulty in meeting MPM's payroll obligation in March 2005, when he understood MPM's financial condition to be in crisis, rather than merely a concern.

The CFO asserts that, although he had direct access to the MPM Board, he was under strict orders from the CEO that all communications with Board members were to go through the CEO. This included a requirement that all written reports from the CFO to the Board be reviewed and approved by the CEO.

While the CEO confirmed that he required written reports from senior staff for Board meetings and that he reviewed them in advance, he denies prohibiting the CFO from directly contacting Board members or pressuring the CFO to 'soften' negative reports. The CEO did acknowledge influencing the CFO to remove personal criticisms from his reports to Board members.

Only the CFO and CEO know the true extent of their mutual understanding of MPM's looming financial crisis during the year preceding its public disclosure.

Only the CFO and CEO know the true extent of their mutual understanding of MPM's looming financial crisis during the year preceding its public disclosure. Our review of documentation and interviews with both parties, as well as MPM Board members, leads us to conclude that the CFO clearly raised concerns about MPM's financial condition beginning in early 2004. However, it is equally clear that the CFO had not fully disclosed to the CEO or the MPM Board of Directors the frequent and growing reliance on Board-restricted funds to sustain museum operations. As MPM's financial condition continued to

decline throughout FY2004 and FY2005, the CEO did not sufficiently heed the CFO's warnings. Further, as head of the organization, the CEO must accept additional responsibility for a climate, already present upon his arrival, of either suppressing negative news from MPM Board members, or continually tempering negative news with optimism and projections of improvement.

MPM Board Oversight

The MPM Board of Directors is comprised of 27 members (see **Exhibit 5**). The County Executive appoints five members and the County Board Chairman appoints four, with the remaining 18 members elected by the MPM Board. Committees of the MPM Board include: Executive, Audit and Finance, Development, Education Programming, Endowment, Human Resources, Government Affairs and Nominating. The Board has no term limits and eight of the members came on the Board before 2000. Prior to 2002, the Board was comprised of 15 appointments by Milwaukee County instead of the current nine County-appointed members. The reduction was made in the context of Milwaukee County's share of total revenues decreasing from 59% in 1991 to less than 23% in 2001.

In our interim report, we noted that, even though the full Board of Directors meets less than monthly, member absences were common.

Each Board meeting agenda includes a discussion of the financial status of MPM. Typically, a review of key statistics highlights attendance and other revenue indicators. Based on our review of Board materials, it was not unusual for a projected shortfall in revenues to be addressed with a plan to adjust expenses to resolve a negative variance from the annual budget. As early as January 2002, for example, it was reported that a \$300,000 revenue shortfall would be addressed with expense reductions. A similar discussion took place at the Board meeting

It was not unusual for a projected shortfall in revenues to be addressed with a plan to adjust expenses to resolve a negative variance from the annual budget.

in April 2002. A decrease in earned revenue was also highlighted at the June 2002 meeting when the 2003 budget was adopted. The February 2003 Board meeting included a discussion of a \$1 million expenditure reduction during the year to deal with several one-time costs. Some concern about risk was also expressed at the June 2003 meeting when the 2004 budget was adopted based on what the COO/CFO called MPM's "stable growth model." Other than these discussions, financial reports generally focused on the growth in MPM operations referenced in the 2004 budget.

Efforts by both the CEO and CFO to omit or minimize adverse financial news would have been exposed by an MPM Board more diligent in exercising its oversight responsibilities.

In our interim report, we concluded that ultimate responsibility for MPM rests with its Board of Directors. Additional audit fieldwork has provided ample evidence that the Board was not fully informed by either the CFO or the CEO, and that the Endowment Committee in particular was indeed misled by the CFO. However, efforts by both the CEO and CFO to omit or minimize adverse financial news would have been exposed by an MPM Board more diligent in exercising its oversight responsibilities.

For example, we noted in our interim report that the Finance and Audit Committee of the Board met only twice a year, once to review and approve the annual budget, and once to review and approve the annual audit. The Endowment Committee, which met only six times during the three-year period 2002 through 2004, typically met for less than an hour. There is little evidence in Board meeting minutes that the financial information that was presented, including reports of budget adjustments due to revenue shortfalls, were questioned.

Corporate boards are responsible for establishing the corporate culture of an organization.

Corporate boards are responsible for establishing the corporate culture of an organization. In placing complete trust in museum management, the MPM Board failed to adequately scrutinize staff reports and indirectly fostered a corporate culture that discouraged frank discussion of the 'downside' risks associated with the aggressive growth experienced by MPM. This same

corporate culture was exhibited by the MPM Executive Committee when it failed to notify Milwaukee County officials of the museum's financial crisis as it unfolded shortly before the Milwaukee County Board of Supervisors voted on the pending \$63 million, 20-year Lease and Management agreement on March 17, 2005.

To help reduce the chance of future financial crises, we recommend MPM:

- 7. Develop specific strategies to foster a corporate culture that encourages, rather than discourages, full and timely disclosure of adverse financial news, as well as potential risks associated with major MPM undertakings. These strategies should address both museum staff and Board/Committee members.*

Referral of Issues

We have provided details of the actions described in this audit report section to the Milwaukee County District Attorney's Office for its review.

Section 3: Factors Leading to MPM's Financial Difficulties

Numerous factors contributed to the financial difficulties that brought MPM to the brink of insolvency in 2005. **Section 3** of this report presents an analysis of those factors as they impacted several key areas of MPM operations.

Attendance

Attendance as reported by MPM during the past five years is shown in **Table 3**.

Table 3 MPM Attendance FY2001—FY2005					
	<u>FY2001</u>	<u>FY2002</u>	<u>FY2003</u>	<u>FY2004</u>	<u>FY2005</u>
Total Paid	371,098	339,373	388,475	409,898	313,129
Total Free	<u>159,969</u>	<u>136,771</u>	<u>138,389</u>	<u>178,108</u>	<u>155,882</u>
Grand Total	531,067	476,144	526,864	588,006	469,011
Five-Year Average = 518,218					
Note: Does not include estimates of facility rental attendance or IMAX Theatre attendance, which is counted separately.					
Source: MPM records.					

For the five-year period, attendance peaked at just over 588,000 visitors in 2004, the year of the blockbuster special exhibit, *Quest for Immortality*. The low attendance point for the period followed the high point, with just over 469,000 visitors in 2005.

Perhaps more telling than the most recent five-year attendance pattern is a comparison of total attendance in 2005 vs. 1992, the year Milwaukee County transferred management responsibility for the museum to MPM, Inc. As shown in **Table 4**, both paid attendance and total attendance was only modestly higher in 2005 than in 1992.

Table 4
MPM Attendance
FY1992 and FY2005

	<u>FY1992</u>	<u>FY2005</u>
Total Paid	287,304	313,129
Total Free	<u>148,640</u>	<u>155,882</u>
Grand Total	435,944	469,011

Source: MPM records.

Expansion and Enhancement of MPM

Making the data comparison in **Table 4** all the more remarkable is the cost and effort undertaken during the intervening years to modernize and enhance facilities and exhibits at MPM to position it to be a successful 21st Century institution.

For instance, since the museum was initially privatized in 1992, MPM has:

- Embarked on a major capital campaign;
- Participated in a joint venture with Discovery World to construct the IMAX Theatre (MPM currently owns the theater outright);
- Participated in a joint venture to purchase the Tirimbina Rain Forest (MPM currently owns that property outright);
- Constructed the permanent *Puelicher Butterfly* exhibit;
- Operated up to eight off-site retail gift shop outlets in three different regions of the state of Wisconsin. [With the closing of the Grand Avenue outlet in January 2006, MPM will no longer operate any off-site retail outlets.];
- Formed affiliations with a farmers' cooperative in Costa Rica to manufacture chocolate bars from cacao plants on its Tirimbina property; and
- Committed to converting the IMAX into a dual-purpose film/planetarium venue.

In the process, MPM has accumulated massive debt. In 1992, the museum had total liabilities of \$878,000. At the end of FY2005, MPM had combined short- and long-term debt of \$28.8 million.

Fundraising

Financial support through contributions and memberships is a major source of funds necessary to help ensure that the museum is able to maintain its operations. Generally, these funds are classified as unrestricted or temporary restricted, depending on whether any specific purposes were attached to the funds pledged.

As **Table 5** demonstrates, unrestricted funds raised through memberships, MPM's annual campaign, and contributions for various museum operations increased steadily from \$2.9 million in FY2000 to \$3.9 million in FY2003. In FY2004, a decrease in unrestricted funds raised of \$800,000 was experienced, to \$3.1 million. The impact of this decrease was much greater, however, as the museum had budgeted revenue of \$5.3 million for FY2004. As a result, the museum had a \$2.2 million shortfall in this area.

Table 5
MPM Fundraising*
FY2000—FY2005

	<u>FY2000</u>	<u>FY2001</u>	<u>FY2002</u>	<u>FY2003</u>	<u>FY2004</u>	<u>FY2005</u>
<u>Unrestricted</u>						
Membership	\$745,476	\$688,137	\$597,589	\$833,692	\$820,670	\$907,447
Annual Campaign	1,469,472	2,364,361	1,871,877	2,061,015	1,661,955	1,772,935
Contributions	673,019	495,108	1,263,166	1,044,416	623,815	680,685
Total Unrestricted	\$2,887,967	\$3,547,606	\$3,732,632	\$3,939,123	\$3,106,439	\$3,361,067
<u>Temp Restricted</u>						
Exhibits	\$3,016,558	\$1,874,898	\$1,473,122	\$953,747	\$217,905	\$1,410,908
Grants	899,116	848,388	172,477	459,133	128,132	2,393
Total Temp Restricted	\$3,915,674	\$2,723,286	\$1,645,599	\$1,412,880	\$346,037	\$1,413,301
Grand Total	\$6,803,641	\$6,270,892	\$5,378,231	\$5,352,003	\$3,452,476	\$4,774,368

* Museum only basis. Based on non-consolidated financial statements.

Source: MPM accounting records.

The decrease in raising temporarily restricted funds over the period FY2000 through FY2004 was even more dramatic, from \$3.9 million to just \$346,000. Totals for temporarily restricted funds reflect a decline in both elements of this classification, grants and pledges for specific exhibits.

MPM uses two resources for its fundraising, its own Development staff and a telemarketing firm. The telemarketing firm's responsibilities included working on new memberships, membership renewals, and the annual campaign. MPM's Development staff is involved in these efforts, as well as soliciting larger pledges related to museum operations and specific exhibits.

Based on reports supplied by Development staff, the telemarketing aspect of the museum's fundraising has not been effective from FY2003 through FY2005. As the data in **Table 6** demonstrates, the amount of money raised through the telemarketing services was minimal during the last three years.

Table 6
Net Funds Raised through
Telemarketing Efforts
FY2003—FY2005

	<u>FY2003</u>	<u>FY2004</u>	<u>FY2005</u>
Funds Raised	\$385,414	\$328,812	\$183,762
Fees Paid	<u>\$353,123</u>	<u>\$346,291</u>	<u>\$155,527</u>
Net Funds Raised	\$32,291	(\$17,479)	\$28,235

Source: MPM Development and accounting records.

State records confirm that the husband of the former Sr. Vice President of Development was President of the telemarketing firm used by MPM during the period FY2001 through February 2004.

State records confirm that the husband of the former Sr. Vice President of Development was President of the telemarketing firm used by MPM during the period FY2001 through February 2004. According to Development staff, a formal Request for Proposal was issued in 2002 and staff recommended a firm other than the one headed by the Vice President's husband. The Sr. Vice President of Development overrode the recommendation of staff and continued to use her husband's firm. It was noted that the firm used by MPM was paid based on an hourly rate, as opposed to the per contact (a phone call answered by a person) basis used by the firm recommended by staff.

To reduce the risk of potential impropriety, we recommend MPM:

8. *Develop conflict of interest policies for managers in a position to influence contract award decisions.*

After the former Sr. Vice President of Development left MPM in December 2003, another RFP was issued and the telemarketing contract was issued to the firm originally recommended by Development staff.

Upon the former Sr. Vice President of Development's departure, the CEO hired a replacement from his former place of

employment. This individual's tenure with MPM lasted from March 22, 2004 through September 30, 2004. Over that six-month period, the Sr. Vice President of Development, who never established permanent residency in Milwaukee, was paid \$110,000 in salary and expenses, as shown in **Table 7**:

Table 7 Salary and Expenses for MPM Sr. Vice President of Development 3/22/04—9/30/04	
Salary	\$94,230
Parking	300
Moving Expenses*	10,000
Transportation to/from Milwaukee & Michigan	<u>5,704</u>
Total	\$110,234
* One-time payment to assist in relocation and procure housing.	
Source: MPM Human Resources Department and accounting records.	

As previously noted, the museum experienced a \$2.2 million shortfall in budgeted contributions and membership and hit a low point for temporarily restricted contributions in FY2004.

Special Projects/Exhibits

Special projects and blockbuster exhibits were part of MPM's strategy for creating a public relations 'buzz,' attracting both new visitors and generating renewed interest from the museum's traditional fan base. Past examples of special projects included construction of the IMAX Theatre, creation of the permanent *Rainforest* exhibit, and the construction of a high-tech glass environ for the permanent *Puelicher Butterfly* exhibit.

The Quest exhibit, MPM's first blockbuster endeavor, set an MPM attendance record with 178,917 paid admissions.

With its *Quest for Immortality* exhibit in 2004, MPM worked with the Egyptian government to bring a world renown traveling exhibit to its only Midwestern stop in the United States. The *Quest* exhibit, MPM's first blockbuster endeavor, set an MPM attendance record with 178,917 paid admissions. While

successful, however, the project was not as profitable as projected. Based on audited financial records, the *Quest* exhibit generated direct revenues of \$5.25 million with expenditures of \$4.4 million, resulting in a net surplus of approximately \$850,000, or about \$264,000 less than projected.

Despite falling short of financial goals, by all accounts, the *Quest* exhibit was successful in attaining prestige and notoriety for MPM as a world-class institution. However, in an apparent effort to balance a difficult budget, the CFO (who was additionally serving in the capacity of CEO, at the time) included \$2,082,010 in *Quest* sponsorship revenue in MPM's FY2004 Budget, *even though virtually the entire amount (\$2,077,490) had previously been recognized as MPM revenue in FY2002 and FY2003.*

Another, far less successful, special exhibit introduced by MPM in FY2005 was the *Pearls: A Natural History* exhibit. According to museum literature, the *Pearls* exhibit traced the lore, legends and facts of the gem. A special pearls gift shop was opened during the length of the exhibit. This special exhibit was projected to general revenues in excess of expenses, with a total budget surplus of \$118,000. However, records show that actual revenues were 43% below projections, while actual expenses exceeded budgeted amounts by 81%. Consequently, the *Pearls* exhibit produced an actual loss of \$523,000, which translates to \$641,000 below budget.

The Pearls exhibit produced an actual loss of \$523,000, which translates to \$641,000 below budget.

The current CEO has publicly pledged to carefully evaluate proposed special exhibits on a stand-alone basis to avoid future losses. He points out, however, that there are special exhibits already in the implementation stage that must be completed due to contractual obligations and sunk costs. We concur with this approach. Obtaining private underwriting of special exhibits will be a key component of this strategy.

To reduce the risk of special exhibits becoming a drain on MPM resources, rather than a public attraction that benefits the museum's 'bottom line,' we recommend MPM:

9. *Carefully scrutinize potential special exhibits and commit resources only to those projects that have a high probability of achieving or exceeding break-even status.*

Grants

In **Section 2** of this report, we identified problems with the use of funds advanced under National Science Foundation grant agreements for purposes other than those permitted under NSF grant requirements. We also noted a fundamental problem with the manner in which management recognized and budgeted grant revenue.

For example, MPM has a five-year cooperative agreement with the United States Department of Agriculture (USDA) covering the period March 30, 2001 through March 29, 2006. The agreement provides funding for a project related to MPM's Tirimbina Rainforest property in Costa Rica. According to USDA documentation, the objective of the project is "to focus upon the restoration of abandoned cacao and develop a regional infrastructure for the commercialization and marketing of agroforestry cacao products through small grower cooperative organizations."

As shown in **Table 8**, initial funding for the project was \$100,000. Each year the federal government earmarked additional funds for the project, for a total of \$695,037 as of January 31, 2005.

Table 8
USDA Appropriations for MPM
FY2001—FY2005

<u>Date</u>	<u>Amount</u>
4/24/01	\$100,000
6/6/02	150,000
3/27/03	150,000
3/2/04	150,000
1/31/05	<u>145,037</u>
Total	\$695,037

Source: USDA Agreements.

Since FY2001, MPM inconsistently recorded USDA revenue. It appears museum staff was recording USDA revenue based on requested amounts, rather than awarded amounts. By FY2004 MPM had overstated USDA revenue by \$200,000. At the request of external auditors, MPM corrected the \$200,000 error in FY2004.

To avoid future problems associated with recognition of USDA grant revenue, we recommend MPM:

10. *Accurately record USDA revenue based upon award notifications, rather than requested grant amounts.*

We noted concerns with the budgeting of grant revenues.

In addition to inappropriate recognition of revenue, we noted concerns with the budgeting of grant revenues. These concerns included budgeting for grant revenue that was already fully recognized in prior years and budgeting a significant amount of revenue in a miscellaneous grant revenue account.

In May 2002, MPM was awarded a \$259,495 NSF grant for the *Science Exploration After School Program*. The grant period covered four years, from July 1, 2002 through June 30, 2006. The funding was to allow MPM to provide under-represented, economically disadvantaged, minority, urban girls in the 6th through 8th grades an opportunity to participate in hands-on

science learning activities, as well as mentoring by scientists in botany, geology, zoology and biodiversity studies.

Although the grant was awarded for a four-year period, the entire grant amount was recognized as revenue in FY2003. While all revenue had been recognized in FY2003, MPM continued to budget for grant revenue in FY2004 in the amount of \$66,498. Since the entire award amount had already been recognized in FY2003, it would not be appropriate to budget for additional revenue in FY2004.

In addition, as shown in **Table 9**, we noted that MPM had budgeted \$600,000 in miscellaneous grant revenue in FY2004. We were unable to determine a basis for the entire \$600,000 budgeted miscellaneous grant amount. We did note there were several grants that had not been included in the budget. Therefore, we included actual revenue amounts for those grants as miscellaneous. As shown in **Table 9**, it appears that MPM had over-budgeted \$625,351 in federal grants revenue.

Table 9
Budgeted Grant Revenue
FY2004

	<u>Budget</u>	<u>Actual</u>	<u>Over (Under) Budget</u>
ELOE	\$55,836	\$58,372	\$2,536
After School	66,498	0	(66,498)
Phylogeny	31,321	31,198	(123)
Estonian	26,867	32,148	5,281
USDA	225,000	150,000*	(75,000)
Grant-Misc.	<u>600,000</u>	<u>108,453</u>	<u>(491,547)</u>
Total	\$1,005,522	\$380,171	(\$625,351)

* Adjusted to reflect the amount that would have been recorded if MPM had consistently recorded USDA revenue.

Source: MPM accounting records.

To help reduce the chance of future budget shortfalls, we recommend MPM:

11. *Budget for grant revenue in a manner that takes into account historical trends and realistic prospects for potential grant awards.*

Gift Shops and Retail Centers

Expansion of retail sales beyond the traditional on-site museum gift shop was one component of an aggressive marketing strategy implemented by MPM.

The expansion of retail sales beyond the traditional on-site museum gift shop was one component of an aggressive marketing strategy implemented by MPM beginning in October 1998 with the opening of a temporary, seasonal sales venue at Mayfair Mall in a suburb of Milwaukee. At various times during the past several years, MPM operated specialty gift shops at retail centers in the Milwaukee area (the Grand Avenue and Mayfair Malls), Madison and Door County. In addition to its main on-site gift shop, MPM also operates a small candy/gift shop near the *Streets of Old Milwaukee* exhibit and, until recently, ran a children's gift shop near the IMAX Theatre. Despite ambitious plans for marketing MPM products throughout the state, retail sales have proven to be a financial drain on MPM operations, as shown in **Table 10**.

Table 10
MPM Retail Sales
Actual vs. Budgeted
FY2000—FY2005

	<u>FY2000</u>	<u>FY2001</u>	<u>FY2002</u>	<u>FY2003</u>	<u>FY2004</u>	<u>FY2005</u>	<u>FY2000- FY2005</u>
Actual Revenues	\$1,530,129	\$1,707,116	\$1,976,626	\$2,047,894	\$2,448,287	\$1,675,509	\$11,385,561
Actual Expenses	\$1,492,399	\$1,866,330	\$2,125,566	\$2,276,965	\$2,773,011	\$2,198,891	\$12,733,162
Surplus/(Deficit)	\$37,730	(\$159,214)	(\$148,940)	(\$229,071)	(\$324,724)	(\$523,382)	(\$1,347,601)
Percent Surplus/Deficit	2.5%	-9.3%	-7.5%	-11.2%	-13.3%	-31.2%	-11.8%
Budgeted Revenues	\$1,939,500	\$2,315,000	\$2,657,000	\$2,529,100	\$2,265,000	\$2,193,600	\$13,899,200
Budgeted Expenses	\$1,557,539	\$1,894,462	\$2,216,230	\$2,325,242	\$1,939,359	\$1,982,094	\$11,914,926
Surplus/(Deficit)	\$381,961	\$420,538	\$440,770	\$203,858	\$325,641	\$211,506	\$1,984,274
Percent Surplus/Deficit	19.7%	18.2%	16.6%	8.1%	14.4%	9.6%	14.3%
Actual vs. Budgeted Net Results	(\$344,231)	(\$579,752)	(\$589,710)	(\$432,929)	(\$650,365)	(\$734,888)	(\$3,331,875)

Source: MPM accounting records and budget documents.

The data in **Table 10** shows that, over the six-year period FY2000 through FY 2005, MPM experienced cumulative losses from retail sales of \$1.3 million. What is more revealing, however, is the comparison of actual vs. budgeted net results. As a result of unrealistic budget projections, MPM experienced cumulative budget deficits from retail sales of \$3.3 million. In other words, despite experiencing consistent losses from retail sales, MPM continued to budget significant surpluses from retail sales, creating constant negative pressure on MPM cash flows.

Hospitality (Restaurants, Concessions, Catering)

The Hospitality cost center at MPM includes concessions, dining, catering and facilities rental operations. With the exception of facility rentals, which are handled by museum staff, these functions are staffed, operated and managed by a private vendor under contract with MPM. Hospitality includes the following operations:

- A lunchroom for school children, who have the option of bringing their own lunches, or purchasing a federally subsidized school lunch.
- A multi-faceted cafeteria-style dining operation including popular menu choices such as pizza and submarine sandwiches.
- A gourmet coffee outlet.
- Vending machines
- Catering services in conjunction with facility rentals. Patrons may rent access to specific exhibit areas, conference rooms or the entire museum.

Table 11 presents the actual vs. budgeted performance of MPM's Hospitality cost center for the period FY2002 through FY2005.

Table 11
MPM Hospitality
Actual vs. Budgeted
FY2002—FY2005

	<u>FY2002</u>	<u>FY2003</u>	<u>FY2004</u>	<u>FY2005</u>	<u>FY2002-FY2005</u>
Actual Revenues	\$2,018,351	\$1,983,231	\$3,021,691	\$1,964,998	\$8,988,271
Actual Expenses	2,057,451	1,988,403	2,810,052	2,089,146	8,945,052
Surplus/(Deficit)	(39,100)	(5,172)	211,639	(124,148)	43,219
Percent Surplus/Deficit	-1.9%	-0.3%	7.0%	-6.3%	0.5%
Budgeted Revenues	\$2,745,000	\$2,595,100	\$3,000,000	\$3,325,083	\$11,665,183
Budgeted Expenses	2,200,000	2,193,320	2,474,048	2,842,288	9,709,656
Surplus/Deficit	545,000	401,780	525,952	482,795	1,955,527
Percent Surplus/Deficit	19.9%	15.5%	17.5%	14.5%	16.8%
Actual vs. Budgeted	(\$584,100)	(\$406,952)	(\$314,313)	(\$606,943)	(\$1,912,308)

Source: MPM accounting records.

As shown in **Table 11**, the Hospitality area of operations was budgeted to generate substantial surplus revenue for each of the four years reviewed. However, actual performance was significantly below projections, with a four-year cumulative deficit of \$1.9 million in actual vs. budgeted net results.

IMAX Theatre

The Humphrey IMAX Theatre opened October 5, 1996. The IMAX was a joint venture of MPM and Discovery World, who formed the Civic Theater Corporation (CTC) to manage and operate the theater. CTC was governed at that time by a six-person board of directors, with MPM and Discovery World each appointing three board members. After setting aside working capital reserves, net operating revenues were to be split evenly between Discovery World and MPM.

In February 1997, Milwaukee County absolved MPM from having to repay approximately \$4.4 million in total debt service cost.

In February 1997, Milwaukee County absolved MPM from having to repay approximately \$4.4 million in total debt service cost associated with bonds issued on behalf of the museum to construct the new access and circulation area that jointly served the IMAX Theatre, Discovery World and MPM. Forgiveness of

this debt had a positive impact on MPM finances, which benefit was absorbed into operations through reduced debt service obligations to MPM for the period 1997 to 2013.

On April 6, 2000, MPM acquired Discovery World's 50% investment in CTC for approximately \$4.1 million. Milwaukee County served as a conduit for the sale of \$4.2 million in general revenue tax-exempt bonds to finance the Museum's purchase. Once the transaction was completed, the IMAX Theater became a department of MPM.

Over the last four years, from FY2002 through FY2005, IMAX attendance averaged 329,677. The FY2005 attendance of 261,195 was 31% below the 376,107 initially realized in 1997, the IMAX's first full year of operation.

The IMAX Theatre, established for purposes of creating an attendance draw for MPM, has been less successful financially than projected, as shown in **Table 12**.

Table 12 MPM IMAX Theatre Actual vs. Budgeted FY2002—FY2005					
	<u>FY2002</u>	<u>FY2003</u>	<u>FY2004</u>	<u>FY2005</u>	<u>FY2002-FY2005</u>
Actual Revenues	\$1,443,266	\$1,545,218	\$1,579,331	\$1,288,318	\$5,856,133
Actual Expenses	1,385,183	1,568,306	1,594,523	1,392,454	5,940,466
Surplus/(Deficit)	58,083	(23,088)	(15,192)	(104,136)	(84,333)
Percent Surplus/Deficit	4.0%	-1.5%	-1.0%	-8.1%	-1.4%
Budgeted Revenues	\$2,083,000	\$1,800,000	\$1,742,625	\$2,068,690	\$7,694,315
Budgeted Expenses	1,687,987	1,477,750	1,400,433	1,798,476	6,364,646
Surplus/Deficit	395,013	322,250	342,192	270,214	1,329,669
Percent Surplus/Deficit	19.0%	17.9%	19.6%	13.1%	17.3%
Actual vs. Budgeted	(\$336,930)	(\$345,338)	(\$357,384)	(\$374,350)	(\$1,414,002)
Source: MPM accounting records.					

As shown in **Table 12**, while the IMAX has essentially operated at or near break-even during the past four years, unrealistic budget projections have resulted in a cumulative deficit of \$1.4 million in actual vs. budgeted net results.

Credit Cards and Travel

MPM makes use of two separate credit card accounts for business purposes. One card is to be used exclusively for travel, while the other is to be used for general purchases. Based on our review of MPM credit card purchases during the period July 31, 2003 through July 23, 2004, a number of concerns were identified. Specifically:

- MPM's policy of a \$1,000 limit on purchasing card transactions was routinely violated. This included purchases that simply exceeded the limit, as well as purchases where a transaction was split to keep it under the limit. In several instances, the per-transaction limits associated with the card far exceeded the \$1,000 policy limit.
- The card issued to the CFO had no limits associated with it. Lacking this basic control, the CFO was able to use the procurement card to make two payments totaling \$52,726 to a legal firm as partial settlement of legal fees in arrears. The first payment of \$27,151 was authorized on February 22, 2005, while the second payment was authorized three weeks later, on March 16, 2005. MPM did not have sufficient funds to make the payment by conventional means.
- Travel purchases were made on MPM's general purchasing card instead of the card that was to be used for travel items.

In July 2005, MPM took action to reduce the number of purchasing cards issued to staff, established specific monthly limits on all cards and provided guidelines for their proper use.

A common trait noted throughout our analysis of several MPM cost centers was MPM's failure to adjust revenue projections for subsequent year budgets to recognize actual performance trends.

MPM Budgeting Practices

A common trait noted throughout our analysis of several MPM cost centers was MPM's failure to adjust revenue projections for subsequent year budgets to recognize actual performance trends. This was particularly true in development of the FY2004 budget, which the CFO prepared while he held the formal title of

Chief Operating Officer/Chief Financial Officer, and was acting Chief Executive Officer as well. As previously described, examples of unrealistic budgeting for FY2004 include:

- Retail sales, budgeting a surplus of \$325,000 for an area of operations that had consistently experienced substantial losses. The net operating results for retail sales in FY2004 was \$650,000 below budget.
- IMAX Theatre, budgeting a surplus of \$342,00 for an area of operations that had consistently performed at about break-even levels.
- Grants, with budgeted revenues overstated by approximately \$625,000.
- Special exhibits, with approximately \$2 million in previously recognized *Quest* revenue budgeted for FY2004.

Thus, the CFO's frequent references to cash flow problems in e-mails to the newly hired CEO during FY2004 were largely self-imposed.

To help ensure the preparation of realistic budgets in the future, we recommend that the MPM Audit and Finance Committee:

12. *Place additional emphasis on scrutinizing proposed budgets, including review of prior years' actual to budget comparisons.*

General State of Records Maintenance

Throughout audit fieldwork, we encountered a variety of difficulties in obtaining specific items such as past MPM Board packets, authoritative policies, signed copies of contracts, etc. In some instances, policy documents were marked 'draft' and a determination of whether a policy was authoritative required manual searches through board or committee meeting minutes. Additionally, meeting minutes were frequently brief and vague. While museum staff was cooperative and helpful in locating various documents we requested, in totality, we found MPM's general state of documentation in need of improvement.

Therefore, we recommend MPM:

13. *Establish and maintain a filing system that facilitates easy identification and access to all formally adopted resolutions and policies of the MPM Board of Directors and its committees. This should include a central repository of all MPM Board meeting and committee meeting packets.*
14. *Prepare and maintain more precise minutes of all MPM Board and committee meetings.*

Although MPM, Inc. by-laws require that all items of indebtedness are to be approved by its Board of Directors, there are no formal policies or protocols for determining whether particular items are included on MPM Board agendas. MPM staff told us that MPM Board agendas are developed by senior staff in consultation with the Board Chairman. If there is a question as to whether or not an item should be included on a Board agenda, it is reviewed by one of two Executive Committee members, both of whom are attorneys, for final disposition.

For instance, in August 2000, the outgoing CEO negotiated a retirement benefit that allowed him to purchase, at the museum employee monthly premium rate, health insurance for upon his retirement until he reaches his 66th birthday, provided he is not employed by another firm. Because the museum at that time was self-insured, monthly premium costs charged to employees (established through the collective bargaining process) may or may not cover actual health care expenses incurred. However, the inclusion of the CEO and his spouse under family coverage during a portion of his retirement was not brought before the MPM Board for approval. According to a letter from one of the MPM attorneys that set Board agendas, it was unnecessary to bring the item before the MPM Board because the CFO had indicated the additional coverage would be cost neutral for the museum.

To ensure that information appropriately placed before the MPM Board of Directors for consideration are included in meeting agendas, we recommend that MPM:

15. *Establish specific criteria and protocols for the development of all MPM Board and Committee meeting agendas.*

Section 4: Additional Challenges Facing MPM

Discovery World

The Milwaukee Public Museum is part of a complex that includes the IMAX Theatre and Discovery World (the James Lovell Museum of Science, Economics and Technology). While the IMAX is now a part of MPM operations, Discovery World is independently owned and operated on Milwaukee County land. During 2006, it is anticipated that Discovery World will relocate to the new Pier Wisconsin building on Milwaukee County's lakefront. The move was viewed by MPM as an opportunity to acquire the Discovery World facility for use as a center for programs consistent with MPM's natural history education mission. Potential partnerships with universities were to be explored.

In August 2004, MPM entered into a \$6 million purchase agreement to acquire the space vacated by Discovery World's anticipated relocation.

In August 2004, MPM entered into a \$6 million purchase agreement to acquire the space vacated by Discovery World's anticipated relocation. A lump sum of \$5 million was to be paid in September 2006 and annual payments of \$200,000 would be due in each of the next five years. It was MPM tentative plan to develop the space into an Education Center. Given the financial situation at MPM in August 2004, it is difficult to comprehend the underlying rationale for making this commitment. Fortunately, there appear to be several contingencies in the purchase agreement that may forestall the need to execute the transaction. It is not clear, however, whether invoking the contingencies would go unchallenged by Discovery World.

It is also not clear what impact the relocation of Discovery World will have on MPM's operations, including admissions, concessions, retail sales and IMAX attendance. Presently, MPM handles the admissions to Discovery World through its ticketing system. As part of providing this service, MPM receives 24 cents per admission. In addition to this revenue, MPM also bills

Discovery World for its share of maintenance costs related to the common entrance area.

Since MPM maintains and manages the ticketing system, it initially receives all of the revenue processed through the ticketing system for admissions to Discovery World. According to Discovery World management, costs for services provided by MPM and revenues from Discovery World admissions have not been properly reconciled for about the last year. MPM is currently working with Discovery World to come to agreement on this issue.

Table 13 shows the number of visitors who purchased a combination ticket for either Discovery World/MPM or Discovery World/IMAX Theatre during the past five years.

Table 13 Combination Ticket Purchases MPM/Discovery World/IMAX Theatre FY2001—FY2005					
	<u>FY2001</u>	<u>FY2002</u>	<u>FY2003</u>	<u>FY2004</u>	<u>FY2005</u>
Discovery World plus MPM	10,446	12,925	12,590	9,617	5,383
Discovery World plus IMAX	<u>4,359</u>	<u>4,251</u>	<u>2,973</u>	<u>2,212</u>	<u>1,578</u>
Total	14,805	17,176	15,563	11,829	6,961
Five-Year Average = 13,267					
Source: MPM attendance records.					

It is difficult to predict the ultimate impact of Discovery World's departure on MPM attendance and related revenues. However, the data contained in **Table 13** shows that Discovery World combination tickets averaged 13,267 annually during the five-year period, and was steadily declining during the past four years. Thus, while Discovery World was an added draw for MPM and the IMAX Theatre, it is not a significant source of MPM

attendance, which averaged approximately than 518,000 visitors annually during the same five-year period.

Ideally, the Discovery World space will be occupied by a compatible operation that will be supportive of MPM operations. At this time, we are not aware of any alternatives to the proposed MPM Education Center. Clearly, MPM is in no position to acquire and develop the space as planned.

Consequently, we recommend that MPM:

16. *Develop a strategy for addressing its pending offer to purchase the Discovery World property.*

Tirimbina Rainforest Center

Tirimbina is an 800-acre property that is operated as a not-for-profit education center, research facility and rainforest preserve.

In 1994, MPM entered into a joint venture with Riveredge Nature Center to own and operate Tirimbina Rainforest Center (TRC) in Costa Rica. Tirimbina is an 800-acre property that is operated as a not-for-profit education center, research facility and rainforest preserve. Acquisition of Tirimbina was funded by private donations of \$250,000. A Costa Rican company, which is a wholly owned subsidiary of TRC, holds actual ownership of the Tirimbina land. This arrangement accommodates requirements on operations imposed by the government of Costa Rica. By-laws of TRC Inc. state that, if the corporation is dissolved, the land is to be distributed to a non-profit organization dedicated to land preservation and conservation. In 2004, ownership of the preserve was consolidated and MPM became the sole owner. A \$100,000 education fund was also established as part of the transaction. TRC has paid half of this amount into the education fund.

MPM's audited financial statements for FY2004 record the value of TRC assets at \$703,394. Of this, land is recorded at a value of \$272,185 and furniture and equipment at \$232,425. Other assets include buildings and cash. Approximately \$80,000 in land and fixed assets was purchased after March 2004.

For FY2005, the TRC budget includes \$270,050 in revenue and \$262,663 in expenses. Primary revenue sources include donations, leases and rent and a fee from Centro Neotropico Sarapiquis (which operates a lodge with a museum and garden adjacent to Tirimbina). The largest expense categories are salaries, \$149,970, and travel/tour costs, \$26,500.

Some elected officials have questioned the ownership of 800 acres of foreign land at a time when MPM faces the need for a public guarantee of a \$6 million loan. Sale of Tirimbina was also an issue that was raised by bankers during discussion of the loan agreement. MPM initially responded with an explanation of the philanthropic support of TRC and its compatibility with MPM's mission. However, in an effort to resolve concerns about the property, MPM has considered selling the rainforest land to a new or restructured TRC.

According to Corporation Counsel, Milwaukee County does not have a direct role in the approval of such an arrangement. The banks holding MPM's debt have a security interest in the property and would have to agree to the transfer.

To assist in recovering from its overextended financial position, we recommend that MPM:

17. *Pursue the sale of Tirimbina and place proceeds of the sale into a reserve fund.*

Artifacts

MPM is caretaker of about 6.5 million artifacts that are owned by Milwaukee County.

MPM is caretaker of about 6.5 million artifacts that are owned by Milwaukee County. As part of our audit, we performed limited tests of valuable inventory items, such as jewelry, and physically identified the presence of all items tested. Many of these items are maintained for research or historic archival purposes; a substantial number have no realistic prospect of public display. Individual collection items having a value of over \$50,000 are insured at a total of \$22.4 million. Exhibits and diorama with an

individual value of more than \$50,000 are valued for insurance purposes at an additional \$28.9 million.

It may be worthwhile to consider sale of assets that are not essential to the mission of the museum and where the donor does not have a concern. Consideration should only be given to items that could be disposed of consistent with donor wishes and items that do not fit the museum's core mission. There are accepted industry standards related to the sale of any assets from the artifacts collection. According to the American Association of Museums, the association's code of ethics stipulates that proceeds from the sale of collections are not to be used for anything other than acquisition or direct care of collections.

However, few public museums are in the dire financial condition of MPM. Since these items are the property of Milwaukee County taxpayers, any proceeds of such a sale should be applied to long-term needs of the museum that are the object of public support, such as capital improvements and major maintenance requirements, as opposed to current operational support. Some items in MPM's inventory have considerable value. For instance, a painting that is currently on loan to the Milwaukee Art Museum has an insured value of \$555,000.

To assure that museum inventory is put to optimal use, we recommend that MPM:

18. *Prepare a list of possible items for County Board de-accession approval.*

Section 5: Conclusions

Ultimate responsibility for MPM rests with its Board of Directors.

The severity of MPM's financial difficulties were concealed or misrepresented.

It is a matter of dispute whether the severity of MPM's financial situation was clearly communicated by the CFO to the CEO.

In our interim report, we concluded that overall responsibility for MPM's financial situation rests with its Board of Directors. We described a series of events where the Board did not pick up on periodic assertions of financial difficulty. The CEO did not believe that the situation was as severe as it was, and the CFO, who knew the severity of the problems, did not go directly to the Board with his concerns. Upon review of MPM financial transactions and related documents in greater detail, we have concluded that the former CFO engaged in a series of actions that concealed or misrepresented the severity of MPM's financial difficulties to MPM Board members and Endowment Committee members for an extended period of time.

It is a matter of dispute whether the severity of MPM's financial situation was clearly communicated by the CFO to the CEO. It is clear that the CFO repeatedly raised concerns to the CEO about the museum's poor performance in fund-raising, beginning in February 2004, or approximately the mid-point of FY2004. However, it is not at all clear that the CFO informed the CEO of frequent withdrawals, outside of policy parameters, from the Endowment Fund. In fact, in an e-mail from the CFO to the CEO dated December 16, 2004, the CFO stated:

"Grants. I need to address the refund of [name] grant of \$100k. Been hoping that we would have gotten even one of our own by now to replace our cash balance at NSF, but no luck. Not sure where to go for this one except to reserves but we have already drawn more than \$700K this year and hoping not worsen that, may have no choice. On this one I want to see where we go with the last two weeks of December and make a strategic decision to cover from payables. If not, we will likely go to reserves."

Aside from the reference to MPM's inability to produce advanced NSF grant funds that should have been restricted from use (see

report **Section 2**), the CFO's reference to 'reserves' is troubling. Since MPM had no reserve funds at its disposal, the only resources the CFO could be referring to with the use of that term is the Endowment Fund. The CFO's treatment of the Endowment Fund as a reserve account, to be accessed as a contingency fund rather than the restricted trust fund that it was, goes to the heart of MPM's financial crisis.

In two separate interviews, the former CFO expressed disagreement with some of the conclusions we have drawn from our audit fieldwork. He particularly objects to our conclusions regarding his responsibility to fully inform the MPM Board of the museum's financial situation, insisting that the former CEO, as well as the MPM Board, wanted a singular voice from MPM staff—that voice being the CEO's. The former CFO also adamantly proclaims the failure to meet fundraising goals was the primary reason for MPM's financial problems, and that he fully informed the former CEO of MPM's dire financial condition. We stand by the conclusions in both our interim and final audit reports.

In either event, we reiterate our conclusion that the CFO knew, or should have known, as early as March of 2004, when he first 'borrowed' Endowment Fund resources to support museum operations, that MPM was in a seriously deteriorating financial state. Further, the CEO knew, or should have known, the same reality. It was at this time that both these individuals, along with the MPM Board Secretary/Treasurer, signed a security agreement with a creditor bank that committed "...all inventory...all revenues, rents, issues, profits, income, and receipts derived in any fashion from all sources...." as collateral for credit extended. Clearly, these individuals collectively failed to inform Milwaukee County of MPM's fragile condition throughout negotiations for a long-term lease and management agreement.

A climate of continuous growth was promoted by MPM administrators and embraced by its Board of Directors, but fundraising was inadequate to sustain such ambitious growth.

Our additional work reinforces our interim report conclusion that a climate of continuous growth was promoted by MPM administrators and embraced by its Board of Directors, but that fundraising was inadequate to sustain such ambitious growth. The result is an organization that saw its financial position decline from one of relative strength in 2001 to near insolvency in 2005.

A recap of our interim report recommendations is included as **Exhibit 6.**

Audit Scope

The objective of this audit was to identify and analyze the factors leading to the sudden disclosure in May 2005 of severe financial problems at the Milwaukee Public Museum, Inc.

The audit was conducted under standards set forth in the United States Government Accountability Office *Government Auditing Standards (2003 Revision)*, with the exception of the standard related to periodic peer review. Limited resources have resulted in a temporary postponement of the Milwaukee County Department of Audit's procurement of a peer review within the required three-year cycle. However, because the department's internal policies and procedures are established in accordance with Government Auditing Standards, and because this audit was performed in compliance with those policies and procedures, the absence of a peer review did not affect the results of this audit. The Milwaukee County Department of Audit has a letter of commitment for a peer review to be scheduled in 2006.

We limited our review to the areas specified in this Scope Section. During the course of the audit, we:

- Obtained and examined MPM's audited consolidated financial statements for the years 1999 through 2004 and unaudited financial statements for 2005, as well as other key financial supporting schedules and documentation.
- Obtained and reviewed available MPM's Board of Directors meeting minutes and attachments, as well as Finance and Audit Committee minutes and attachments, for the period 1999 to date.
- Obtained and reviewed available MPM's Executive Committee minutes and attachments, as well as Endowment Committee minutes and attachments, for the period 2001 to date.
- Obtained and reviewed MPM's Endowment Fund's Statement of Investment Objectives, Policies and Guidelines, as well as its Spending Policy.
- Obtained and reviewed MPM's 21st Century Capital Campaign literature and campaign contribution results.
- Interviewed MPM's former and current CEO, former, interim and current CFO, former and current Controller, a number of members of the MPM Board of Directors and members of the Endowment Committee, as well as other key financial and administrative staff.

Date: May 16, 2003

Exhibit 2
(Page 1 of 2)

To: Endowment Committee

From: [CFO]

RE: Fund Performance Update

The following report is an update of the fund performance for the Endowment Committee for the period ending 04/30/2003. Since we have not met as a group, the report will include performance since the start of our fiscal year on 09/01/2002.

Historical Comparison

As a way of re-introducing our plan for the committee, the Endowment Funds as of the date of our last meeting and a comparison to the last meeting are as follows:

	<u>5/31/2003</u>	<u>Difference</u>	<u>8/31/2002</u>	<u>Difference</u>	<u>8/30/2002</u>
Funds Invested	\$ 6,127,673	-1,896,093	8,023,766	-659,219	8,800,570
Funds held at M&I (Cash)	750,000	750,000	0	0	0
Restricted Funds (Grants)	1,796,000	0	1,796,000	0	1,796,000
Total	\$ 8,673,673	-1,146,093	9,819,766	-659,219	10,596,570

The reduction in investible funds is as follows:

Repayment of Bond Funds to Bank One [®] and M&I on investible funds	\$ -1,100,000	0
Net Realized and Unrealized Losses on the fund for the 11 month period	15,342	-659,219
Bank Service Fees and Trust withdrawals	-61,435	0
Total Difference	\$ -1,146,093	-659,219

Overall the fund experienced its market losses in fiscal 2002 with a total loss of \$649,000 during the period from June through August.

In fiscal 2003, the fund balance has experienced a slight increase for the year of \$150,000. The increases in value occurring principally in the months of March and April of 2003.

The corporation under its bond agreement with Bank One and M&I is required to make payments to the banks on moneys received that were restricted in nature within 13 months of receipt of such funds. During this period, the corporation would normally have expected to make some level of return on those funds, but in fact, lost unrealized value during the holding period, as such the restricted payment holding period did not have the desired effect that was intended.

The corporation also maintained a separate cash account in support of a Letter of Credit for \$750,000 in regards to the Quest for Immortality Exhibit. Donor pledges for this amount have been committed to the corporation but were not collected as of the date of the Letter of Credit. The Letter of Credit is for the final payment of the exhibit fee due in August of 2004. Donor funds are expected to be received in the next 6 to 9 months. The impact of the funds being kept in cash were that it reduced the negative impact of unrealized gains experienced in the fund during the reporting period. With more stable market conditions, the corporation expects to return these funds into the investible funds and replace these funds with donor pledge proceeds.

Fund Performance

The attached report from Alpha investing provides a basis for evaluating fund performance for the reporting period.

As indicated, the Daruma funds performance was up 7.6% for the month of April, -.4% in March and up 4.8%

for the last quarter. On a fiscal year to date basis, the fund was down 7.3%.

The Artisan Midcap fund was up 6.4% for April, .9% for March, and 6.0% for the last quarter. On a fiscal year to date basis, the fund was up 2.8%.

The Vanguard Index Fund was up 8.3% for the month of April, 1.0% for March, and 7.7% for the last quarter. On a fiscal year to date basis, the fund was up 1.3%.

The Master Select fund was up 13.1% for the month of April, -.2% for the March, and 6.5% for the last quarter. On a fiscal year to date basis, the fund was down 5.8%.

The Baird Intermediate Bond fund was up 1.1% for the month of April, .1% for March, and 2.4% for the last quarter. On a fiscal year to date basis, the fund was up 5.1%.

Overall, the fund was up 6.5% for the month of April, .5% for the month of March, and 5.5% for the last quarter. On a fiscal year to date basis, the total funds up 1.4%.

Fund Withdrawals

The corporation had \$19,980 in bank service fees from M&I that was not loaded into investment returns. The corporation also withdrew funds for required projects including Myrtle Baer for \$17,247, Starr Internship for \$4,404, \$11,457 for Nehken (Egypt research),

The corporation did not take its annual 3% withdrawal against the endowment fund given the market losses experienced during the last 9 months. We may re-evaluate that decision at the close of the fiscal year after finalizing the spending policy distributed at the last meeting.

**Endowment Committee Report
9-10-04**

For the period ending 06/30/2004, total funds available including investible funds of \$4.6 with cash holding of \$1.1M. The total of \$5.7M as of June was equal to the previous quarter. For the 6 months from January 1 to June 30th we earned \$250,000 in earnings.

No draws or requests for draws for trust activity were made for the six month period.

\$500,000 were drawn from the investible funds as a hedge against making the covenants for 08/31/2004. The draw was needed because the museum fell significantly behind its targeted operating cash total despite the strong success of Quest for Immortality. Development and Membership cash flow was approximately \$2,000,000 behind plan and placed pressure on the ability for the corporation to maintain its liquidity position.

The trend above caused the allocation formula to be out of balance but was re-balanced as of end of year. The re-balanced totals are provided to you for reference. Quarterly management will meet with representative of Alpha Investments to review the impact of re-balancing the portfolio in accordance with the investment policy.

Of concern is the drop in cash flow for the corporation in fiscal 2004. Declines in revenue to plan from Development and Grants, total cash flow is \$2.5M below plan. \$1.5M was planned to be deposited into endowment funds for investment. That was not achieved. The impact to achieving our long term goals may not be significant with the advent of a capital campaign likely in late 2005, but in the short run it will reduce investment earnings targets for the endowment and will create the need to revise bank covenants again for the second year in a row on the basis of cash and investment position.

The 2005 operating plan for MPM has provided more modest goals for grants and development revenue so achievement of cash flow goals will be easier than the 2004 goals. However, we do not have plans currently to replace these funds lost in 2004. As such, I will present revised targets for the Committee that Mike Stafford will endorse for growth in Endowment Funds for the period of 2005-2007. These revised targets will provide a backdrop for setting earnings goals and growth in net assets for endowment assets.

At year end we should take time to review fund performance and transaction costs for the fiscal year ended at 08/31/2004. We will also review operating performance for the fund including trust related expenses.

Exhibit 3
(Page 2 of 3)

Milwaukee Public Museum, Inc.

Asset Allocation Summary

Categories	Amounts	Target Allocation	Current Allocation	Current w/ Cash
Aggressive Equities	1,852,673	20	40.6	32.9
Large Cap Equities	1,308,300	35	28.7	23.2
International Equities	1,143,624	15	25.1	20.3
Intermediate Fixed Income	241,435	25	5.3	4.4
Cash	1,080,485	5	0.3	19.2
Total	5,626,517	100	100	100

Milwaukee Public Museum
ASSET ALLOCATION SUMMARY
June 30, 2004

Categories	Target Allocation	Current Allocation	Investments	Market Value
Aggressive Equities	20.0%	40.6%		
		21.2%	Daruma	\$969,308
		19.4%	Artisan Midcap	\$883,365
Large Cap Equities	35.0%	28.7%	Vanguard Index 500	\$1,308,300
International Equities	15.0%	25.1%		
		25.1%	Master Select	\$1,143,624
Intermediate Fixed Income	25.0%	5.3%	Baird Intermediate	\$241,435
Cash	5.0%	0.3%	Cash (includes project fund)	\$15,697

TOTAL MARKET VALUE	<u>\$4,561,728</u>
NET CASH FLOW DURING QUARTER	(\$591,871)
MARKET VALUE PREVIOUS QUARTER (March 31)	<u>\$5,119,322</u>
GAIN(LOSS) DURING QUARTER	\$34,276
GAIN(LOSS) FISCAL YEAR TO DATE	\$867,950
GAIN(LOSS) CALENDAR YEAR TO DATE	\$251,665

Subject: Development
Date: Sun, 18 Jul 2004 08:18:59 -0500
From: [CFO]
To: [CEO]

[Name]

In preparation for the Monday meeting with Mike Hilliard, I want to summarize the issues, risks, and my recommendations before the meeting to insure we are in agreement ahead of time.

Facts

For fiscal 2004, Development revenues on an accrual basis will be behind plan by \$1.7M. On a cash basis that number will be \$1.6M. On a cash basis we will have received \$3.7M of which \$600K is old pledges that were collected. That means that we actually collected only \$3.1M of new money in the fiscal year. That will be our lowest total since 1999. On an accrual basis we will be at \$4.1M also our lowest total since 2001.

Using the same system as in previous years (these numbers are from Devo not Finance), the areas below plan include the Annual Campaign, under by \$1.1M, Membership, under by \$2.2M, and Quest gifts under by \$4K.

In February, [Name] asked for a reduction in the budget of \$750,000 in cash and accrual. The budget was adjusted with expense reductions totalling \$750,000 committed for by senior staff. That number will actually be \$650,000 since we did not stay within our commitments for some items such as publishing Lore, etc.

Last week, Development advised us that they will not meet plan by \$1.7M. So we now have a shortfall of \$1.1M with 45 days to go in the fiscal year, uncovered. As a point of reference the grants total is still \$500K below plan for the year, with limited prospects to cover this hole also. At our meeting in February, the thought was that we would get to at least that number, so far this year, we are still well short.

The corporation has borrowed against its lines of credit to cover this hole. We have borrowed \$850,000 to cover part of the shortfall and reduced our 21st Century fund by \$991,000 to cover the remaining difference. As a result we will be out of compliance in our bank covenants at end of year. I advised the banks last week of the violation along with asking them to waive the liquidity covenant for 2005 until we begin the new capital campaign.

Impact

The shortfall this year in Development will have significant impact. First, we will have an operating loss on an unrestricted basis this year. In essence, we will not balance our budget. That occurring in the same year as Quest will be difficult to explain, but clearly is not related at all to Quest.

Our cash flow position is seriously compromised. The borrowings should be directed towards Exhibit commitments like Vatican, Scrolls, and business ventures not net operating losses. I have "danced" with the banks on this issue, but this simply is bad business and has to be corrected.

The 2005 budget is seriously compromised. A careful review of that budget reveals that the baseline is \$4.4 with only modestly increasing results for 2005 of \$400K. At the same time we are increasing expenses for that \$400K increase of \$700K. I was not crazy about the ratios but

we did it. Now, the ratios are \$1.7M in new business for a \$700K expense increase. The ratios are more normalized, but given the track record to date, that level of increase is at best a "pipe dream". My sense is that we are off by at least \$1.5M now in the budget. As such, the budget will need to be revised.

Issues

Several items here.

[Name] has brought with him a solid formula for success. The giving pyramid makes perfect sense for MPM. The issue is transition. Many managers fail not from vision but because of process. This failure is a process error. In my discussions with him this week a few things are evident. He has never managed in an environment where making monthly numbers was an issue. It is clear that is an irritant to him. But it is a reality.

The changing in staff priorities has resulted in staff dedicating time to larger gifts, more time to learning the "devo terrain", and focusing on special project giving. All needed steps to make the new system work, but no allowance for the present. The effect is that the Annual Campaign is \$1.1M off of LY. That is our lifeblood. That is cash flow we need to operate. Those are not pledges but checks in small denominations that have been the underpinning of organization. I am positive no thought was given to covering this problem in the transition. Mike H. was not even familiar with it or the problem. That needs to be addressed.

The second issue is Membership. Membership is both a circulation enhancer and the baseline for Development. Between you and [Name] it is also clear that neither one of you have real experience with Membership. Given that it is a \$1.2M item in a \$4M budget, knowledge of this activity is critical. Part of the Annual Campaign problem are the members are levels above \$50. There membership above \$50 goes to the Annual Campaign. Again, as you look into the detail those numbers are way down. You are not off \$200,000 but rather \$450,000. Again, we are moving [Name] to her new role, but you are leaving uncovered 25% of your current results and next year's budget with an unproven manager.

Communication is also a problem. In April, when I wrote up the 6 month analysis, I knew we were not going to make it in Development given the terrible result in December. When we "revised" the report to the Board, we basically said we would make it up. We told that again to them last month. We need to decide how that gets communicated. This is your call. But, in the future, you may want to consider advising this board when something negative occurs early rather than later. This is an issue of credibility for both of us.

The other communication issue is within the Devo area. You and Mike H. are both "big picture" managers. That is good and bad. I have yet to find a time when I cannot yet take my hands off the detail. This is yet another example. The "devil is in the detail". Frankly, it is tiring and frustrating to doing this deep into Devo information. I have been saying for 6 months you have a problem and was assured "everything was on track". The answers are not in high level reports but rather in reviewing the detail. [Name] is a nice person, but she has consistently missed her projections over the years. She was consistent again this year. [Name] is relying on her. He can't. He needs to do it himself. If not, he needs to get a person who can grind data for him and summarize it.

Strategy

[Name] at first, I thought you had a stroke of genius in that the conversion to the cash method for Devo would put the accrual gifts

against your Temp restricted SIM goal thus reducing our temp restricted hole while not being in a capital campaign. The problem seems to be you two are occupied with accrual gifts and no was is attending to the day to day cash flow for Annual Campaign and Membership. I still think the strategy is good but the execution needs revision. How we get there is something I need to understand from the two of you on Monday.

My guess is that this strategy problem was never discussed at the onset. Two solutions exist. The first is that we create a more detailed plan to get to the \$4.8M in cash flow for 2005. That is my preference. It is the easiest. It is also the most politically viable for you. It keeps your credibility with the budget intact.

The second alternative is that we simply revise the budget to reflect a \$1.0-\$1.5 reduction due to the lack of cash flow that will be generated for next year. That means we need to ask senior staff to reduce programs and costs. I realize that your initial thought is to use the \$1.0M cushion that we are starting on. Mike, that will be shortsided. You have too many managers in too many new places to take that approach. Jeff is already asking for a downward revision in his budget for IMAX, Amy is questioning the Pearls admissions goals, Alex is concerned about grants with [Name] and [Name] going. We need a cover this potential shortfall also. The reality is that this mistake by Development in 2004 is a very serious issue for us.

Solutions

[Name] I think three things need to happen. First, tell the Board before I do so at the September meeting. Maybe Tuesday is a good starting point. But you need to decide this for yourself.

Next, you need to get more involved with [Name] on Development, specifically reporting and performance for cash flow. He is not used to this environment and is also only here 4 days a week. Also, assess your staff in this area carefully. They are average at best. They are trying to overachieve and the results are showing.

Finally, we need to re-tool the 2005 budget. [Name] is asking for a week to see if that is needed. I don't need a week. The budget is flawed. So the sooner the better for revisions.

We can talk today or tomorrow before the meeting.

[Name]

2005
Board of Directors
MILWAUKEE PUBLIC MUSEUM

(As of June 2005)

Chairman: David G. Meissner

Chair Elect: Kenneth A. Kerznar

Vice Chairman: V. Ross Read III

Secretary/Treasurer: Edwin P. Wiley

Asst. Secretary/Asst. Treasurer: Charles I. Henderson

President: Michael D. Stafford, Ph.D.

RICHARD E. BEIGHTOL

President, National Worksite Benefits (Retired)

KATHRYN MURPHY BURKE

Community Volunteer

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Milwaukee County Supervisor

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CHARLES I. HENDERSON

Attorney, Davis & Kuelthau

KENNETH A. KERZNAR

Managing Director, J.P. Morgan Securities Inc.

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Community Volunteer

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Community Volunteer

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Executive Director, Private Industry Council

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President & Chairman, Clement Finance & Leasing, Inc.

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Community Volunteer

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RICHARD WEISS

Former Partner, Computer Firm

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Sr. Vice President, Wisconsin Physician's Service

EDWIN P. WILEY

Attorney/Partner, Foley & Lardner

MICHAEL D. STAFFORD, PH.D.

President/CEO, Milwaukee Public Museum

SUSAN FRONK (EX-OFFICIO)

Friends of the Museum Board President

5/23/2005

Milwaukee Public Museum
Board Committees
February 2005

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Kerznar, Kenneth A. – Chairman
Elect; Chair, Audit &
Finance; Chair,
Endowment
V. Ross Read, III – Vice Chair;
Chair, Nominating
Wiley, Edwin P. – Secretary/
Treasurer
Henderson, Charles – Asst.
Secy/Asst Treasurer;
Chair, Human Resources
Stafford, Michael D. – President
McKeithan, Patricia B. – Past
Chair
Beightol, Richard E.
Burke, Kathryn Murphy – Chair,
Education Programming
Frenn, Thomas L. – Chair, Govt
Affairs
Schlifske, John E. – Chair,
Development
Stein, Gerald
Fronk, Susan – President, FOM
Board
*Staff: A Barker, J. Bass, A.
Chionchio, T. Gaouette,
J. Krivitz, P. Sherman-
Cisler, K. Spahn, A.
Young*

Audit & Finance Committee

Kerznar, Kenneth A. – Chairman
Furlong, Mark F.
Henderson, Charles
Lach, Dana M.
Meissner, David G.
Stafford, Michael D.
Staff: T. Gaouette

Development Committee

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Burke, Kathryn Murphy
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Gorham, Charles (FOM)
Graff, Stephen N.
Henderson, Charles
Lindemann, Jean (FOM)
Meissner, David G.
Muller, Rose Mary
Randall, Gerard
Read, V. Ross
Ritchie, Kip
Rush, Leonard (FOM)
Stein, Gerald
Wiley, Edwin P.
Stafford, Michael D.
Staff: K. Spahn

**Education Programming
Committee**

Burke, Kathryn Murphy –
Chairman
Frenn, Thomas L.
Plunkett, Gwen
Randall, Gerard A.
+ 3 outside educators to join
Meissner, David G.
Stafford, Michael D.
Staff: J. Bass

Endowment Committee

Kerznar, Kenneth A. – Chairman
Beadell, Anthony B. (FOM)
Lindemann, Jean S. (FOM)
Meissner, David G.
Stafford, Michael D.
Staff: K. Spahn, T. Gaouette

Human Resources Committee

Henderson, Charles – Chairman
Frenn, Thomas L.
Meissner, David G.
Weiss, Richard
Whitelaw, Essie
Wiley, Edwin P.
Stafford, Michael D.
*Staff: T. Gaouette, P. Sherman-
Cisler*

Government Affairs Committee

Frenn, Thomas L. – Chairman
Cook, Sharon
De Bruin, Lynne
Farrow, Margaret A.
Muller, Rose Mary
Randall, Gerard A.
Ritchie, Kip
Stein, Gerald
Meissner, David G.
Stafford, Michael D.
Staff: J. Krivitz

Nominating Committee

Read, Ross – Chairman
Henderson, Charles
Jennings, Susan
Joerres, Sarah
Whitelaw, Essie
Wiley, Edwin P.
Meissner, David G.
Stafford, Michael D.
Staff: K. Spahn

MPM Board Expirations

The expiration date is the MPM Annual Meeting date in the year following the year noted below.

(year appointed/elected to board in parentheses)

Board Elected:

2005

Murph Burke (2002)
Mark Furlong (2002)
Charles T. Gorham (2005)
Chuck Henderson (2002)
Ross Read (1997)
Ted Wiley (1992)

2006

Dick Beightol (1998)
Margaret Farrow (2004)
Kip Ritchie (2002)
Gwen Plunkett (2004)
Jerry Stein (1992)
-open position-

2007

Angela Colbert (2005)
Ken Kerznar (1992-1999)(2003)
Patti McKeithan (1995)
David Meissner (1992)
John Schlifske (2003)
Dick Weiss (2000)

County Appointed:

2005

Gerard Randall (H) (1993)
Essie Whitelaw (W) (2002)
Dana M. Lach (W) (2005)

2006

Sup. Lynne De Bruin (H) (2004)
Sharon Cook (W) (2004)
*-*open position – (W)*

2007

Michelle Crockett (H) (2004)
Tom Frenn (W) (1992)
Rose Mary Muller (H) (2003)

(H) = appointed by Supervisor Holloway
(W) = appointed by County Executive Walker

5/23/2005

November 2005
Board of Directors
MILWAUKEE PUBLIC MUSEUM

Chairman: John E. Schlifske
Vice Chairman: V. Ross Read III
Secretary/Treasurer: Edwin P. Wiley
Asst. Secretary/Asst. Treasurer: Charles I. Henderson
President: Daniel M. Finley

RICHARD E. BEIGHTOL

President, National Worksite Benefits (Retired)

KATHRYN MURPHY BURKE

Community Volunteer

ANGELA COLBERT

President, Production Stamping Corp.

SHARON COOK

Director, Office of Intergovernmental Relations

MICHELLE CROCKETT

V.P. Community Affairs, Genesis Behavioral Services

MARGARET A. FARROW

Former Lieutenant Governor

DANIEL M. FINLEY

President/CEO, Milwaukee Public Museum

THOMAS L. FRENN

Attorney, Petrie & Stocking

MARK F. FURLONG

President, Marshall & Ilsley Bank

CHARLES T. GORHAM

(Retired) President, Gorham, Inc.

CHARLES I. HENDERSON

Attorney, Davis & Kuelthau

KENNETH A. KERZNAR

Managing Director, J.P. Morgan Securities Inc.

DANA M. LACH

Attorney, Foley & Lardner

PATRICIA BRASH MCKEITHAN

Vice President, Miller Brewing (Retired)

DAVID G. MEISSNER

Executive Director, Public Policy Forum (Retired)

ROSE MARY MULLER

Community Volunteer

GWEN PLUNKETT

Community Volunteer

GERARD A. RANDALL, JR.

Executive Director, Private Industry Council

V. ROSS READ III

President & Chairman, Clement Finance & Leasing, Inc.

KIP RITCHIE

Community Volunteer

JAMES "LUIGI" SCHMITT

Milwaukee County Board of Supervisors

JOHN E. SCHLIFSKE

Senior Vice President, Northwestern Mutual Life

GERALD STEIN

Chief Executive Officer, Zilber Ltd.

MICHAEL J. VAN HANDEL

Exec. V.P. & CFO, Manpower, Inc.

RICHARD WEISS

Retired Partner, Computer Firm

ESSIE WHITELAW

Sr. Vice President, Wisconsin Physician's Service

EDWIN P. WILEY

Retired Partner, Foley & Lardner

SUSAN FRONK (EX-OFFICIO)

Friends of the Museum Board President

**Milwaukee Public Museum
Board Committees
November 2005**

Executive Committee

Schilske, John E. - Chairman;
- Chair-elect
V. Ross Read, III - Vice Chair;
Chair, Nominating: Chair,
Endowment
Wiley, Edwin P. - Secretary/
Treasurer
Henderson, Charles - Asst.
Secy/Asst Treasurer;
Finley, Daniel M. - President
McKeithan, Patricia B. - Past
Chair
Meissner, David G. - Past
Chairman
Van Handel, Michael- Chair,
Audit & Finance
Beightol, Richard E.
Burke, Kathryn Murphy - Chair,
Education Programming
Frann, Thomas L., Chair, Govt
Affairs
Furlong, Mark F. - Chair, Human
Resources
Stein, Gerald
-Chair,
Development
Fronk, Susan - President, FOM
Board (ex-officio)
Staff: A. Barker, J. Bass, M.
Bernaltz, K. Spahn

Audit & Finance Committee

Van Handel, Michael, Chairman
Frann, Thomas L.
Furlong, Mark F.
Plunkett, Gwen
Henderson, Charles
Kerznar, Kenneth A.
Lach, Dana M.
Schilske, John E. (ex-officio)
Finley, Daniel M. (ex-officio)
Staff: M. Bernaltz

Development Committee

Chairman
Beadell, Anthony (FOM)
Burke, Kathryn Murphy
Fronk, Susan (FOM)
Gorham, Charles (FOM)
Graft, Stephen N.
Henderson, Charles
Lindemann, Jean (FOM)
Meissner, David G.
Muller, Rose Mary
Randall, Gerard
Read, V. Ross
Ritchie, Kip
Rush, Leonard (FOM)
Stein, Gerald
Wiley, Edwin P.
Schilske, John E. (ex-officio)
Finley, Daniel M. (ex-officio)
Staff: K. Spahn

Education Programming Committee

Randall, Gerard A., Chairman
Frann, Thomas L.
Plunkett, Gwen
+ 3 outside educators to join
Schilske, John E. (ex-officio)
Finley, Daniel M. (ex-officio)
Staff: J. Bass

Endowment Committee

Read, V. Ross (MPM), Chairman
Beadell, Anthony B. (FOM)
Colbert, Angela (MPM)
Kerznar, Kenneth A. (MPM)
Lindemann, Jean S. (FOM)
Moebius, Robert (FOM)
Schilske, John E. (ex-officio)
Finley, Daniel M. (ex-officio)
Staff: K. Spahn, M. Bernaltz

Human Resources Committee

Furlong, Mark F., Chairman
Frann, Thomas L.
Henderson, Charles
Meissner, David G.
Weiss, Richard
Whitelaw, Essie
Wiley, Edwin P.
Schilske, John E. (ex-officio)
Finley, Daniel M. (ex-officio)
Staff: M. Bernaltz, P. Schneider

Government Affairs Committee

Frann, Thomas L., Chairman
Cook, Sharon
Farrow, Margaret A.
Muller, Rose Mary
Randall, Gerard A.
Ritchie, Kip
Stein, Gerald
Schilske, John E. (ex-officio)
Finley, Daniel M. (ex-officio)
Staff: D. Finley, K. Spahn

Nominating Committee

Read, Ross, Chairman
Henderson, Charles
Jennings, Susan
Joerres, Sarah
Whitelaw, Essie
Wiley, Edwin P.
Schilske, John E. (ex-officio)
Finley, Daniel M. (ex-officio)
Staff: K. Spahn

Exhibit 5
(Page 5 of 6)

11/14/2005

MPM Board Expirations

The expiration date is the MPM Annual Meeting date in the year following the year noted below.

(year appointed/elected to board in parentheses)

Board Elected:

2005

Murph Burke (2002)
Mark Furlong (2002)
Charles T. Gorham (2005)
Chuck Henderson (2002)
Ross Read (1997)
Ted Wiley (1992)

2006

Dick Beightol (1998)
Margaret Farrow (2004)
Kip Ritchie (2002)
Gwen Plunkett (2004)
Jerry Stein (1992)
Mike Van Handel (2005)

2007

Angela Colbert (2005)
Ken Kerznar (1992-1999) (2003)
Patti McKeithan (1995)
David Meissner (1992)
John Schlifske (2003)
Dick Weiss (2000)

County Appointed:

2005

Gerard Randall (H) (1993)
Essie Whitelaw (W) (2002)
Dana M. Lach (W) (2005)

2006

Jim "Luigi" Schmitt (H) (2005)
Sharon Cook (W) (2004)
_____ (W) (2005)

2007

Michelle Crockett (H) (2004)
Tom Frenn (W) (1992)
Rose Mary Muller (H) (2003)

(H) = appointed by Supervisor Holloway
(W) = appointed by County Executive Walker

**Audit Recommendations from June 2005
Audit of MPM 2005 Financial Crisis Interim Report**

1. Obtain the final 2004 independent audit of MPM's financial statements as soon as possible and require that future audits are provided to Milwaukee County within 180 days of the fiscal year-end.
2. File annual budgets, audits and quarterly financial statements with both the Milwaukee County Department of Audit and the Department of Administrative Services. Quarterly financial statements should be filed within 15 days after completion of the quarter in a form acceptable to the County.
3. Include, in MPM's annual contract with an independent audit firm, the requirement that the firm cooperate with requests from the Milwaukee County Department of Audit for information and records related to MPM audits.
4. Revise policies and procedures to ensure proper checks and balances to prevent the improper use of restricted funds. This would include establishing specific parameters for access to Friends of the Museum and Endowment Fund assets, as well as a dual authorization requirement on all appropriate transactions.
5. Assess the MPM Board size, structure and procedures with the goal of enhancing administrative oversight capabilities.
6. Establish a monthly or quarterly meeting cycle of the MPM Audit and Finance Committee.
7. Review for approval all MPM mid-year budget modifications beyond a specified threshold.
8. Ensure that public meetings contain enhanced detail on the reason for invoking closed sessions.
9. Review the criteria applied in hiring a Chief Executive Officer to ensure candidates have a well-rounded administrative experience, including appropriate financial acumen.
10. Separate the duties of Chief Operating Officer and Chief Financial Officer.
11. Discontinue use of employee separation agreement that may hinder a candid, public discussion of key activities of MPM.
12. Reduce standard buy-out provisions contained in standard administrator contracts from one year to a period that provides for more immediate relief in times of financial stress, such as 90 days.
13. Milwaukee County reevaluate due diligence procedures to ensure that all potential impacts are assessed prior to entering into ventures with private entities.

One alternative that should be considered is the retention of an outside firm whenever time limits or the need for special expertise warrant. This will require an additional expense. Another enhancement would be to include, in future agreements, an 'out' clause that gives Milwaukee County the sole discretion to withdraw from a venture if full disclosure has not been made.



November 30, 2005

Jerome Heer
Director of Audits
Milwaukee County Department of Audit
City Campus, 9th Floor
2711 West Wells Street
Milwaukee, WI 53208

Dear Mr. Heer:

On behalf of the Board of Directors of Milwaukee Public Museum, Inc, I want to thank you for an opportunity to respond to the draft of the final report on the MPM 2005 financial crisis. As always, I welcome your scrutiny and recommendations in order to make our Museum the best it can be.

I want to commend you for the honest and direct approach in which you handled the audit. Our financial revelations from early this year along with subsequent restructuring actions have made it an especially difficult time for our staff. Your team's genuine concern for both the taxpayers and a venerable institution made the process a fair one to all under extraordinary circumstances.

Of those Board members and staff who have read the report, we generally concur with its findings. The document is accurate, well written and straightforward. Your document corroborates most of what our own internal analyses have shown. The Board's primary concern is that the situation occurred in the first place and for this we apologize to the people of Milwaukee County and all those who put their faith in us.

The immediate cause of the financial crisis may be simply formulated: MPM's expenses of operation greatly outgrew its current operating revenues and sources of support. Beginning in early FY 2002, prior management began to cover operating revenue shortfalls from reserve funds raised in a capital campaign (FY 1999-2001) which the Board had dedicated to repayment of bonded indebtedness (\$14,500,000 in FY 2003) incurred to finance several major capital additions. The causes of these shortfalls were primarily attributable to:

- Net losses from operations relied upon for net revenues, such as retail sales, restaurant and facility rental and IMAX Theater admissions
- Significant reductions in governmental support

- Declining unrestricted contributions
- Sizable increases in non-revenue generating operating expenses, principally personnel, benefits and facilities maintenance

By early 2005, the temporarily restricted reserves, the 21st Century Fund and permanently restricted endowment were all depleted and thus left MPM unable to satisfy accruing obligations including payroll. As a consequence, MPM was compelled to enter into financing arrangements with its creditor banks, which the banks required to be guaranteed by Milwaukee County.

How could this happen? The Board failed to take any actions prior to March 2005 because it simply was unaware of the magnitude of the problems. Key management failed to inform the Board of growing financial problems. Key management also utilized misleading and overly aggressive accounting practices that further hindered the Board's ability to fully grasp the deteriorating financial situation. During this period, the Board was unaware of these accounting practices. Finally, and perhaps most importantly, reports were presented at Board and committee meetings that either failed to highlight the financial problems or actually misrepresented the situation. For instance, many of the transfers from the reserves were never disclosed to the Board. As a result, the Board had an entirely different understanding of MPM's financial situation than what was actually happening. When these issues finally came to the Board's attention, the key management personnel responsible were replaced.

In short, the Board relied too heavily on trusted management. This trust dulled the Board's critical analysis and lulled it into accepting overly optimistic reports. For this we are truly sorry.

No matter how trustworthy and competent management may seem to be, its performance must be subject to regular and thorough scrutiny by the Board. This has been a very harsh lesson for the MPM Board. It is a mistake for which the Board takes full responsibility.

The Board has already taken many corrective steps. Subsequent to the release of the preliminary audit (June 10, 2005), the Board has aggressively pursued a recovery plan to rebuild the Museum's fiscal foundation. John Schlifske, a senior vice president at Northwestern Mutual, took over as chairman; Michael Van Handel, the chief financial officer of Manpower, Inc. joined the Board and now chairs our audit and finance committee. We also have a new president/CEO, Dan Finley, and a new CFO, Michael Bernatz, with solid management credentials especially in the area of fiscal responsibility and financial controls. The 2006 budget is balanced on a cash basis; we have new independent auditors, we changed to more accurate and conservative accounting policies, and we have enacted many new internal controls to prevent these problems from ever occurring again. We have been more open with key constituencies regarding matters at MPM (namely the County and the Financial Oversight Committee). Finally, we have instituted new policies and procedures for Board committees (in particular the audit and finance committee) which increases the frequency of meetings and which greatly expands and improves Board oversight of management.

Prior to our comments on the final audit, we would like to provide you with a brief update on our compliance with the recommendations of the preliminary audit:

1. Provide the FY2004 independent audit to the County Board.

Completed. Also provided copy to Financial Oversight Committee (FOC).

2. File all financial statements with the County.

Completed. Regularly provide County with all FOC reports.

3. Include in MPM's annual contract with an independent auditor that the firm cooperate with all requests from the County.

Completed. Provision has been added to contract with new auditor Virchow Krause.

4. Revise policies to ensure proper use of restricted funds.

Completed. Board adopted several sets of new policies, which separated funds and required multiple signatories to transfer money.

5. Assess MPM Board.

Ongoing. Michael Van Handel has been added to the Board and serves as chairperson of the audit and finance committee. Two MPM union employees are being added to the Board as required by the new union and management agreement.

6. Establish monthly or quarterly meetings of the MPM Audit and Finance Committee.

Completed. However, the committee will meet bi-monthly.

7. County to review mid-year budget modifications.

Ongoing. Since the MPM FY2006 budget is only 75 days old, there have been no mid-year adjustments. The FOC is kept fully aware of all MPM matters.

8. Ensure that public meetings contain enhanced information for invoking closed session privileges.

Ongoing. This detail is now added as standard operating procedure and furthermore, closed sessions are kept to a minimum.

9. Review training and qualifications for the CEO.

Completed.

10. Separate the duties of the COO and CFO.

Completed. There is no longer a COO position.

11. Discontinue use of employee separation agreements that hinder public discussion of MPM activities.

Ongoing. This will happen when necessary but fortunately there has been no need since the release of the preliminary audit.

12. Reduce standard buy-out provisions in contracts for senior staff.

Ongoing. All management contracts have either been amended or are scheduled for amendment by the end of 2005. 90 days of severance will be the standard. Currently the CEO has no severance provision.

The following are clarifications of concerns raised in the final audit:

- The aggressive growth model was a business strategy developed by the former CFO.
- The revised losses in FY2004 reflected accounting changes with capitalization and some unrecorded adjustments recommended by the auditor.
- The audit does not mention the accounting changes, which dealt with the reclassification of the temporarily restricted funds to unrestricted funds. While the change was to a method that was more easily understood, it resulted in a screen, which obfuscated transfers from the 21st Century Fund. MPM has found no evidence of internal control violations other than the policy on withdrawal.
- The seven-year \$2.75 million lease for planetarium equipment and installation was in clear contravention to the planetarium donor's wishes and understanding.
- While some bank restrictions were not adhered to, the banks were not insisting on compliance. There were no missed payments, just restriction issues. This problem is overstated in our opinion.
- Upon further review, it is clear some staff were aware of the contract with the company of a senior vice president's husband. This obvious conflict in violation of the existing conflict of interest policy should have been reported to the MPM Board.
- To be clear, the MPM Board did not know the full extent of the crisis until the Starshak report of April 2005.

The following are our comments on the specific recommendations contained within the final audit. The CEO is responsible for administering all these recommendations and the Board bears ultimate responsibility for compliance with the recommendations and overall stewardship of the institution.

1. Obtain investment statements summarizing endowment funds.

Completed. This will be administered by the CFO and overseen by the audit and finance committee. The endowment committee will also now report on all cash withdrawals to the Board.

2. Obtain Board approval for all indebtedness.

Completed. This has always been the policy it was just not followed. The FOC must also be informed of all such actions. The CEO will administer.

3. Ensure restricted gifts are used only for intended purposes.

Completed. Substantial new controls are in place.

4. Finalize new agreement with planetarium donor.

Ongoing. The draft agreement is complete and in the hands of both parties. Finalization is expected in December.

5. Discontinue advancing federal funds for unallowable costs.

Completed.

6. Draw advances of federal funds in accordance with federal policies.

Completed. All policies will be closely followed.

7. Develop strategies to encourage the disclosure of adverse news.

Ongoing. This will be done as part of a governance review process the Board has undertaken with contracted help. We plan to establish by early spring 2006 effective "whistle blowing" procedures whereby all MPM employees are encouraged to express serious concerns about management performance and breaches of policies on a confidential basis.

8. Develop conflict of interest policies for managers.

Completed. MPM has had a policy in place for senior management since 2004—a statement is completed annually by senior staff and was first included in the annual statement to the Board in 2005. In addition, each employee receives and signs off on an employee handbook upon hire, which includes a conflicts of interest policy (in effect since January 1998).

9. Better scrutinize financial viability of special exhibits.

Ongoing. The CEO and Board have pledged to have full underwriting of future exhibits. However, there are current and future exhibits contracted by previous management that must go forward or significant penalties could be exacted against MPM. Both the Board and FOC have been informed of the status of these exhibits.

10. Accurately record USDA revenues.

Completed. These policies have been developed with the help of independent auditors.

11. Conservatively budget grant revenue.

Completed. Revenue will only be budgeted once official notification has been received.

12. Better scrutiny of proposed budgets with comparisons to actuals.

Ongoing. This practice was implemented with the creation of the FY2006 budget and will be used hereafter.

13. Establish a better filing system for Board materials and actions.

Ongoing. Strides have been made but more work needs to be done. This will be completed by August 31, 2006.

14. Maintain more precise meeting minutes.

Ongoing. We will ensure that all Board and committee meetings minutes be appropriately detailed and thoroughly checked prior to issuance – effective immediately.

15. Establish criteria for meeting agendas.

Ongoing. MPM will abide by Wisconsin open meeting laws and any modifications of other agenda criteria will be implemented through By-Law changes, subject to County Board approval, to be completed by August 31, 2006.

16. Develop a strategy to address Discovery World offer to purchase.

Ongoing. Discussions are underway with the other principal who has shown remarkable open-mindedness. The intention is to have this resolved by September 2006.

17. Sell Tirimbina.

Ongoing. All tenets and provisions of the bank agreements are being complied with. It should be kept in mind the land is a nature preserve under Costa Rican law and thus sale options are limited.

18. Prepare a list of items to deaccession.

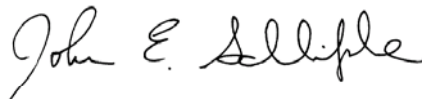
This item is of particular concern. Widely accepted ethical standards for the museum profession forbid the use of proceeds from the sale of deaccessioned objects for purposes of this kind. This action is also forbidden in MPM's collection policy and statement of ethics. Our concern is not with the idea of reviewing collections to be certain all collections foster the museum's mission; indeed the museum is already undertaking such a review as it relates to fine art paintings. Instead, it is with the recommended uses of the funds from these sales that violate standards. MPM, Inc. continues to pursue the highest ethical standards in its collections and research departments, and care and curation of the objects in its custody have not been faulted in the audit. Adopting this recommendation would be a violation of ethical standards.

It was essential that MPM accelerate efforts to correct policies and practices outlined in the audit. The need to restore public trust is paramount to the success of the institution and at the center of Museum governance.

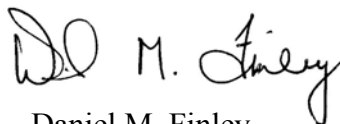
The Board is already aggressively questioning management plans and reports, and new charters will soon be in place guiding the work of each Board committee. A new strategic plan is to be completed by early next summer.

I look forward to working with you over the months ahead to restore the Museum's financial stability and help it regain its preeminence as one of America's great natural and human history museums.

Sincerely,



John E. Schlifske
Chairman of the Board



Daniel M. Finley
President and CEO

JES:DMF/ts